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Higher Education Alert

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IRS memorandum concludes NIL collectives are not tax exempt

By Matthew Netti

The IRS General Counsel found that name, image, and likeness (NIL) collectives do not qualify for tax exempt status under 501(c)(3).



What's the Impact?

- / The memorandum lays out a firm stance taken by the IRS on the tax status of NIL collectives.
- / NIL collectives should be cautious around soliciting tax deductible donations from boosters and operating as a traditional nonprofit under 501(c)(3).

On the heels of *NCAA v. Alston (2021)*, a case in which the Supreme Court called into question the NCAA's athletics model, the NCAA adopted an interim name, image, and likeness (NIL) policy in July 2021. The policy permitted NCAA student athletes to profit from their own publicity rights, opening the door to receive compensation for NIL activities subject to certain limitations. Limited parameters set by the NCAA included barring NIL activities in which compensation was contingent on enrollment at a particular school or athletic performance, and requiring NIL agreements contain quid pro quo, meaning student athletes must be compensated for work performed.

In the two-year aftermath of the NCAA's NIL policy adoption, a patchwork of state laws and university-specific NIL policies have created a cloud of confusion with little uniformity for student athletes and university administrators. Congress has yet to adopt federal legislation on the issue, leaving student athletes in the dark on many NIL-related issues. In an attempt to help navigate the uncertain NIL space, many organizations referred to as "NIL collectives" have been established. NIL collectives are third-party entities that operate outside the confines of an educational institution comprised of boosters and fans of a school's athletic program that facilitate and fund NIL deals for student athletes. Essentially, these organizations pool funds from a wide array of donations to create NIL deals for student athletes at a specific institution. To date, there are over [200 collectives serving student athletes](#) across the country with approximately 80 claiming nonprofit status.

501(c)(3) status

Section 501(c)(3) of the Internal Revenue Code provides an opportunity for organizations to be tax exempt if an organization operates exclusively for one or more of the exempt purposes listed. Examples of exempt purposes set forth in Section 501(c)(3) are the advancement of religion, the advancement of education, and eliminating prejudice and discrimination. An organization will be considered as operating exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes specified in section 501(c)(3).¹ If more than an insubstantial amount of an organization's activities are not in furtherance of an exempt purpose, that organization will not qualify for tax exempt status.

Organizations that qualify under 501(c)(3) are often referred to as charitable organizations, serving a public rather than a private interest. The organization must not be formed or operate for the benefit of private interests and the net earnings may not inure to the benefit of any private individual. An organization must establish that it is not operated for the benefit of private interests.²

If an organization is exempt under 501(c)(3), it receives certain tax benefits including exemption from federal income tax. NIL collectives have the large incentive of obtaining tax exempt status in order to receive tax deductible contributions, allowing the large donations awarded by boosters to be written off as a donation to a charity. The ability to solicit tax deductible contributions empower NIL collectives to receive large donations, which can be used to compensate student athletes for NIL-related activities such as charity appearances, speaking engagements, social media marketing, and more.

IRS Memorandum

On June 9, 2023, the IRS Office of the Chief Counsel released a significant 12-page memorandum ([memorandum number AM 2023-004](#)) analyzing the activities of NIL collectives for tax-exempt status. The memorandum, dated May 23, 2023, concludes that in many cases NIL collectives are

¹ Treas. Reg. § 1.501(c)(3)-1(c)(1).

² Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

operating for a substantial nonexempt purpose serving the private interests of student athletes, which is more than incidental to any exempt purpose furthered by the collective. Consequently, NIL collectives do not qualify for tax exempt status under 501(c)(3), and therefore cannot receive tax deductible contributions from boosters and other organizations.

IRS analysis of NIL collectives' activities

The IRS completed a fact-specific analysis into the activities of NIL collectives across the country, applying the actions taken by collectives to well-established law. The operational test has been developed to ensure that an organization is devoting its resources and activities to further exempt purposes. Under the operational test, the purpose toward which an organization's activities are directed determines whether an organization qualifies under 501(c)(3). Often, an organization's activities will further both exempt and nonexempt purposes. Under this analysis, the next inquiry is whether the nonexempt purpose is incidental to the exempt purpose, such that the organization nevertheless qualifies for exemption under 501(c)(3).³

Also, the operational test requires an assessment of the private benefit conferred by an organization's activities. If any private benefit exists, it must be "clearly incidental to the overriding public interest."⁴ The private benefit must be both qualitatively and quantitatively incidental. When an organization's activities result in a direct benefit to designated individuals, the private benefit is not qualitatively incidental to exempt purposes. For the private benefit conferred to be considered quantitatively incidental, the private benefit must be insubstantial in amount when compared to the overall public benefit. The IRS memorandum cited an example of an organization's activity of which the private benefit conferred was not considered quantitatively incidental to the public benefit. An organization formed to promote modern art trends by exhibiting and selling local artists' work was not considered tax exempt under 501(c)(3) because the individual artists were conferred a direct substantial benefit by receiving 90% of the proceeds of the organization's sales.⁵

Balancing public interest against private benefit

When applying the operational test and assessing the private benefits conferred by NIL collectives, the IRS found that, in most cases, the benefit of the private interest will be more than both qualitatively and quantitatively incidental. The backdrop surrounding NIL collectives concerns the NCAA's decision to allow student athletes to profit from their own NIL rights. Through NIL collectives, student athletes benefit from the compensation paid for use of their NIL. Student athletes seek out the services of NIL collectives for opportunities to be compensated for speaking at a charity events, posting on social media, attending athletic camps, and more. The benefited

³ *Christian Manner International, Inc. v. Comm'r*, 71 T.C. 661 (1979); Cf. *Copyright Clearance Ctr., Inc. v. Comm'r*, 79 T.C. 793, 808 (1982).

⁴ Rev. Rul. 76-206, 1976-1 C.B. 154.

⁵ Rev. Rul. 76-152, 1976-1 C.B. 151.

persons, here the student athletes, need not own or operate an organization for the private benefits conferred to be considered impressible.⁶

When weighing the scales of public interest against private benefit, the IRS concluded that NIL collectives' activities tipped too far in favor of private benefit. The IRS questioned what charitable purpose NIL collectives are serving by paying student athletes in exchange for services. The IRS concluded that NIL collectives' services do not qualify as furthering educational purposes under 501(c)(3). Furthermore, benefits to student athletes extend beyond just compensation, as in most cases NIL collectives are enduring the compliance and transaction costs to participate in NIL deals. Certain NIL collectives proclaim that 100% of contributions will be paid to student athletes, so boosters fund the collective's administrative costs, licensing fees, and other expenses.

Additionally, the IRS considered the interest of athletic directors, boosters, and fans of a certain school when assessing NIL collectives. As NIL has gained traction among student athletes, it has become a recruiting pitch to athletes. NIL collectives are aimed at serving student athletes at a particular school, rather than making their services available to any student athlete willing to participate.

The memorandum concludes, "[c]onsequently, it is the view of this Office that many organizations that develop paid NIL opportunities for student athletes are not tax exempt and described in section 501(c)(3) because the private benefits they provide to student athletes are not incidental both qualitatively and quantitatively to any exempt purpose furthered by that activity."

Takeaways

While the memorandum cannot be used or cited as precedent, the memorandum lays out a firm stance taken by the IRS on the tax status of NIL collectives and likely signals future action to come.

Moving forward, NIL collectives should be cautious around soliciting tax deductible donations from boosters and operating as a traditional nonprofit under 501(c)(3). Even if an NIL collective has previously been granted recognition of nonprofit status, continuing to operate as a 501(c)(3) organization poses a substantial risk.

Furthermore, boosters seeking to write off donations to NIL collectives as tax deductible should be aware of the IRS's new position.

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⁶ See *Am. Campaign Acad. v. Comm'r*, 92 T.C. 1053, 1069 (1989).

