

Using the Tax Code to Help Universities Put Big-Time College Sports in (Some) Perspective

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Richard Schmalbeck, [Ending the Sweetheart Deal between Big-Time College Sports and the Tax System](#), **Duke Law School Public Law & Legal Theory Paper** (2014).

The modern university is a precious institution, providing a wide variety of benefits to society. But it is constantly in danger of being turned into something far less valuable, ironically by the very people who claim that “creating value”—but only in a very limited sense—should be the narrow goal of higher education. In addition, through political channels as well as financial incentives, universities are pressured to discontinue certain lines of research, to violate academic freedom, and in a variety of other ways to undermine independent academic inquiry. In the face of these ubiquitous and increasing pressures, it is essential that universities continue to defend their traditional role in society.

One quintessentially American collegiate tradition, however, has recently gained disproportionate influence in our universities. Big-time college sports programs have become dangerously influential on far too many campuses. It is important to remember that universities do not need to derive funds from operating lucrative sports programs. Many great American universities do not do so (for example, NYU, University of Chicago, and Carnegie Mellon), while others do so at lower levels of competition (the Ivy League, elite liberal arts colleges, and so on). Nevertheless, far too many top-flight institutions have increasingly committed themselves to being competitive in the sports that generate large amounts of revenue from television and merchandising: football and men’s basketball. That most of those institutions actually lose money on those “revenue sports” has not discouraged more and more universities from trying to win a piece of that revenue pie. The illusory promise of big money from sports has created many problems for American universities, but many proposals to address those problems are deeply misguided. In particular, as I have written (e.g., [here](#) and [here](#)), recent calls to allow cash payments to players would move us in exactly the wrong direction.

In *Ending the Sweetheart Deal between Big-Time College Sports and the Tax System*, Professor [Richard Schmalbeck](#) takes a different tack, explaining how the current federal tax system exacerbates the problem and increases the incentives for universities to become ever more ensnared in the big-time sports trap. He describes two tax provisions—universities not having to pay the Unrelated Business Income Tax” (UBIT) on their sports-related profits, and a provision allowing a partial deduction for barely disguised added charges for admission to games—that are “egregiously bad,” and he concludes that “these defects amount to an implicit tax subsidy of college sports that is neither healthy nor in any way justified.” Because of space limitations, I will focus here only on the first provision. Suffice it to say that Professor Schmalbeck’s arguments regarding the second provision are as strong as those for the first, which is to say very strong indeed.

The Internal Revenue Code currently permits universities to run their athletic departments like for-profit businesses, without requiring them to pay taxes on “unrelated business income.” Nonprofit tax status generally means that an institution need not pay taxes in a given year, even in years when its revenues exceed its expenditures, so long as the institution meets various requirements imposed by the tax code and Treasury Regulations. There are, for example, limitations on compensation for the institution’s officers, minimum requirements for disbursements of funds, and so on.

What raises Professor Schmalbeck's ire (and mine) is not that universities are running side businesses. Any nonprofit can do that, if it likes, so long as it pays UBIT. These rules generally should also apply to public universities that run unrelated businesses. Professor Schmalbeck notes, however, that Congress, in enacting UBIT in 1950, went to great pains to make clear that football and basketball could not possibly be subject to the tax. The particular claim by supporters of these giveaways was that big-time sports are meaningfully "related" to the nonprofit mission of the American university. The IRS followed suit, and there is little doubt that any effort today to tax the business activities of the big-time athletic departments would send politicians into a frenzy, defending dear old State U. from the supposedly grasping hands of the tax man.

Professor Schmalbeck's analysis is especially strong in the section where he challenges a later IRS ruling that "the educational purposes served by exhibiting a game before an audience that is physically present and exhibiting the game on television or radio before a much larger audience are substantially similar." One can almost hear Professor Schmalbeck shout, "Are you kidding me?!!" He lays out all of the ways in which entertaining the in-person audience might be in some way "related" to the educational purpose of the university, although those connections are (as he would be the first to admit) already pushing the limits of credulity. For example, although it is true that members of a university's community who are "loyal fans" might well commit large amounts of money to watching their favorite teams in person, so do fans of the very openly profitable New York Yankees and Dallas Cowboys.

But as much of a stretch as all of that might be, the argument for calling the television audience similarly "related" to the educational purpose is laughable. The typical viewer is unlikely to have "any interest in the educational enterprise that is associated with the universities whose student-athletes are on the field." Professor Schmalbeck is too polite to directly mock the claim that the TV exposure builds "school spirit," and instead addresses the argument seriously, noting that the only evidence to support that conclusion merely suggests that athletic success helps a tiny handful of schools increase their applications on a very temporary basis.

Moreover, he argues that we cannot assume that it is beneficial to the university "that a few applicants whose interest in the university was based largely on its athletic success were displacing a similar number of applicants who were almost as well-qualified, and had been attracted to the university by its other qualities." Finally, he finishes by noting that "generating greater name recognition would not seem to be, in itself, sufficiently related to the university's exempt purposes to take an activity out of the range of the unrelated business income tax." He humorously describes various ways in which a university could connect its name to for-profit activities, which would enhance the name recognition of the university, but that cannot possibly be "related" to the exempt purpose in any meaningful sense.

Importantly, Professor Schmalbeck does not overstate his case. He concedes that the net impact of the two changes that he proposes would not suddenly turn big-time college sports into small-time entertainment—although he convincingly argues that the effects could be noticeable and beneficial. He also concedes that, as noted above, many politicians will line up against any such proposed reforms. In the end, however, he concludes that the battle would be worth fighting because the reforms would "improve the coherence and fairness of the federal income tax."

I wholeheartedly agree. Even so, my reason for supporting Professor Schmalbeck's proposal has little to do with improving the tax code, as laudable a goal as that might be. My concern is with the American university system, which already has enough trouble fighting the many corrupting influences that will always swirl around it. We should pursue any opportunity to reduce one of the most corrupting of those influences, even just a little bit. Whether it is for the good of the tax code, or the good of universities, however, Professor Schmalbeck's proposals deserve to be taken seriously.

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