IRS Scrutiny May Underlie Move Away From NIL Collectives

By **Andrew Hope and Emily Crim** (March 12, 2025)

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In what appears to be a growing trend among Power Four schools, the University of Colorado athletic department announced in January that it was ending its partnership with the name, image and likeness collective, 5430 Alliance.

Colorado joins the University of Alabama and the University of Notre Dame, which terminated partnerships with their university-associated booster collectives late last year.

In a mass email to fans and donors, Colorado Athletic Director Rick George requested that donations be redirected to the university rather than to a third-party collective.

In the email, George cited upcoming changes to National Collegiate Athletic Association rules, which will follow implementation of the landmark $2.78 billion settlement of In re: College Athlete NIL Litigation, a consolidated antitrust class action — sometimes referred to as House v. NCAA — filed against the NCAA in the U.S. District Court for the Northern District of California.

U.S. District Judge Claudia Wilken granted preliminary approval of the proposed settlement in October 2024 and a hearing for final approval is scheduled on April 7.

Under the settlement, NCAA member institutions would be permitted to make direct NIL payments to student-athletes beginning this fall.

However, the recent push to move NIL activities in-house seems equally motivated by tax implications and increased scrutiny by the Internal Revenue Service.

Under a direct payment model, universities can potentially streamline funding mechanisms and enhance transparency while also mitigating legal risks by distancing themselves from organizations that are not compliant with IRS regulations.

Yet the decision to adopt such a model is fraught, as terminating partnerships with collectives could limit financial support for athletes, at least in the short term.

Background

Immediately following the U.S. Supreme Court's June 2021 ruling in NCAA v. Alston, the NCAA adopted its initial NIL policy, which formally allowed student-athletes to profit from use of their name, image and likeness.

This led to a proliferation of collectives, which pool money from boosters and other donors to create paid marketing and endorsement opportunities for college athletes. A number of these collectives are organized as nonprofit entities under Section 501(c)(3) of the Internal Revenue Code.

To qualify for tax-exempt status under Section 501(c)(3), an entity must be organized and operated exclusively for exempt purposes, which may be charitable, scientific or educational.

To satisfy the organizational test, an organization's articles of incorporation or other foundational documents must include language limiting the organization to exempt purposes and establishing that its assets will be permanently dedicated to an exempt purpose.

The operational test examines whether the organization engages primarily in activities that accomplish its exempt purposes and if it primarily serves a public rather than private interest. If the organization serves both public and private interests, any private benefit resulting from its activities must be incidental, both qualitatively and quantitatively.

To be qualitatively incidental, a private benefit must be necessary to or a byproduct of the organization's exempt activities. A private benefit is quantitatively incidental if the amount is insubstantial compared to the public benefit.

Clearing the operational test is the major hurdle facing NIL collectives. Unlike the organizational test, which looks only to the four corners of an entity's corporate filings, the operational test examines what the organization actually does.

The primary activity of most NIL collectives is compensating student-athletes, resulting in a direct benefit to a limited group of individuals. Further, this private benefit to student-athletes is hardly insubstantial, especially where NIL collectives promise to pay athletes 80%-100% of total contributions received, as is often the case.

Increased Scrutiny

On June 9, 2023, the IRS Office of Chief Legal Counsel issued a generic legal advice memorandum outlining its concerns regarding NIL activities by nonprofit collectives, ultimately concluding that many of these entities are unlikely to be deemed to serve an exempt purpose under the U.S. tax code.

A series of letter rulings followed in June and July 2024, with the IRS denying tax-exempt status for NIL collectives because they failed to meet their burden under the operational test, and the qualitative and quantitative aspects of the Section 501(c)(3) requirements, as set forth in the June 2023 memo.

Then, on Oct. 29, 2024, the IRS Tax Exempt and Government Entities Division released a program letter identifying "tax-exempt collectives utilizing Name, Image, and Likeness (NIL)" as one of its compliance enforcement priorities for 2025.

Most recently, on Jan. 24, the IRS publicly released an Oct. 31, 2024, final determination letter, concluding that a collective that contracted with student-athletes to perform charitable work failed to satisfy the requirements for charitable purposes under Section 501(c)(3) because the NIL payments under the agreements were not merely incidental to private interests, and therefore outweighed the charitable purposes.

The implications of these rulings are profound, potentially leading to increased tax liabilities and penalties for collectives and individual donors. In the absence of the tax incentives associated with nonprofit designation, collectives can expect a steep decline in donations.

Also, as programs grow more reliant on NIL money to attract talented high school recruits

and athletes via the NCAA transfer portal, many have wrestled with the options available under for-profit models, while others, notably the University of Maryland and the University of Wisconsin, have announced the need to reevaluate operational expenses and levels of support for nonrevenue sports.

The future for NIL collectives as tax-exempt entities is uncertain, at best. Despite its repeated public statements over the past six months, the question going forward is whether the IRS will have the necessary resources or political will to pursue enforcement actions in this area.

Adding to this uncertainty is President Donald Trump's nomination of Billy Long to serve as the next IRS commissioner. A former U.S. Representative, Long repeatedly co-sponsored legislation to abolish the agency he is now tapped to lead. If confirmed, Long could shift priorities away from current enforcement efforts targeting wealthy individuals and corporations, including those involved in NIL activities.

NCAA Legislation

Though it has yet to do so, there is always the possibility that Congress will step in to provide a measure of clarity. In September 2022, a bipartisan bill was introduced in the U.S. Senate that took aim at the tax incentives associated with tax-exempt NIL collectives.

The proposed legislation — titled the Athlete Opportunity and Taxpayer Integrity Act — included a provision that would bar donors from claiming tax deductions for donations to collectives for NIL payments to student-athletes, but did not make to the floor for a vote. The bill was reintroduced in 2023 and suffered the same fate, though the growing impact of NIL in college sports may finally impel Congress to act.

The momentum for a legislative solution has increased since last fall, following preliminary approval of the class action settlement and the results of the national election, which saw Republicans gain control of the House of Representatives, the Senate and the presidency.

Indeed, it would seem that passage of comprehensive NIL legislation is now more likely than ever. Sen. Ted Cruz, R-Texas, the newly elected chair of the powerful Senate Commerce Committee, sponsored the 2023 NIL bill and has publicly stated that college sports are in a state of crisis and risk devastation if Congress fails to act.

In January, Cruz announced that college sports reform would be one of the major priorities of the current legislative session.

Previous efforts to pass federal NIL legislation have failed to advance out of committee. However, as the new head of the Commerce Committee, Cruz is now ideally situated to shepherd a bill to the floor for a vote and appears to enjoy the administration's support in establishing a federal NIL standard.

While details of a bill have not been publicized, Cruz and other members of Congress are working on a bipartisan basis to draft proposed legislation that would likely grant the NCAA limited antitrust protection, and officially declare that student-athletes are not employees.

Since the 2021 Alston decision, the landscape of college athletics has experienced a seismic shift. The NCAA has lobbied for congressional action for over a decade and may see those efforts finally bear fruit with the support of Cruz and the Commerce Committee.

However, many unresolved issues remain, with increased scrutiny from the IRS emerging as the latest challenge. Given the complexity and rapid evolution of the NIL landscape, it seems that all parties would benefit from a set of clear, consistent rules that protect athletes, institutions and donors, while also ensuring fair competition and a level playing field.

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