

## Take a lesson on tax exemption from the National Football League

In the face of continued Congressional criticism, the National Football League announced last month that it would give up its status as a tax-exempt trade association.

Understanding the reasons for the league's exempt status—and the reasons that it decided to give it up—yields important lessons for trade associations and their members across all industries.

There are many types of tax-exempt organizations. The 501(c)(3) charitable organization is the most familiar. However, other types of exempt organizations include unions, social clubs, cemeteries and, as relevant here, trade associations.

Different types of tax-exempt status convey different benefits. For example, donations to charitable organizations are generally tax deductible, but dues paid to social clubs generally are not, absent a business purpose for the expenditure. Both types of organizations, however, do not pay tax on income that they earn from their operations.

The tax code provides a special exemption for “business leagues.” The most common type of organization to which this applies is trade associations, such as the Monroe County Bar Association or the Greater Rochester Association of Realtors.

In general, a business league is an association of people with a common business interest, the purpose of which is to promote that common interest. In order to qualify, the organization's activities must be devoted to improving business conditions of one or more lines of business as a whole, as distinguished from performing particular services for specific companies or dealers in a particular brand.

The distinctions between organizations that meet these requirements and those that do not can be quite subtle. For example, the IRS has stated that advertising that carries the names of members may be performing particular services, and thus prohibited; but that promoting the business of an industry by encouraging the use of its products is not.

In addition to meeting these requirements, business leagues can't engage in a regular business of a kind ordinarily carried on for profit and their earnings can't



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be returned to or otherwise inure to their members or others.

Do sports leagues meet these requirements?

The key question is whether they really further the interests of the industry as a whole or only the interests of their member organizations.

Leagues differ in the positions that they take. The NHL and PGA claim to be tax exempt. However, the NBA does not claim exemption and Major League Baseball stopped claiming exemption in 1997.

To my mind, whether trade association status properly applies to sports leagues in general is an open question. As to professional football, however, the answer is right in the tax code: In the 1966 law allowing the merger of the NFL and AFL, Congress added special language stating that professional football leagues qualify as exempt trade associations. As a tax matter, for the NFL, the law is clear.

Then why did the NFL give up its exemption?

The immediate reason was Congressional criticism. Given the incredible profits earned by professional football, the league's exempt status became low-hanging fruit, despite the fact that the profits are earned by the teams, not by the league office. Congressional critics made negative public statements about the league's exemption, introduced legislation to repeal it, and even threatened to call the commissioner to Washington to testify regarding the exemption.

It's not clear what the financial benefit of the exempt status actually was to the league. The Joint Committee on Taxation estimated that revoking the league's exempt status would bring in an estimated \$109 million over the next 10 years. How-

ever, the league office is not intended to make a profit; in fact, in two of the last three years, it ran a deficit. From an income tax perspective, it seems that there is very little for the league to lose, especially as it can manage its affairs over time to minimize profits at the league office.

Reliable information about the non-income tax benefits of the league's exempt status is hard to come by, but potential benefits may include exemptions from state and local taxes and ability to obtain certain types of tax-exempt financing, which could potentially be material.

In the end, however, the league decided that whatever the tax benefits of trade association status were, they simply weren't worth the hassle. In a letter released late last month, Commissioner Roger Goodell stated that the NFL intends to file as a taxable organization beginning this year, calling the issue a “distraction” and stating that taxable status “will make no material difference to our business.”

One immediate benefit of the change is that the league's financials—and Goodell's salary—will no longer be public. The annual tax returns filed by business leagues are accessible to the public and readily available on the Internet. Becoming a taxable organization will allow the league to conduct its activities without public scrutiny of its finances. (This is reputed to be the reason that Major League Baseball gave up its exemption.)

The controversy over the league's tax-exempt status yields lessons for less glamorous industries.

Individual trade associations must ensure that they benefit an entire line of business, not just their members, and that their assets don't inure to their members or others. Profit centers need to reside outside of the trade association. The association needs to be prepared for public disclosure of financials.

While the fuss over the league's tax-exempt status may be much ado about very little tax, it reinforces the fact that trade associations are a specific creature of the tax law and that care needs to be taken to ensure compliance with its requirements.

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