

## Will the Nick Saban Tax Apply to Nick Saban?

by Stephanie Cumings

A new excise tax that targets the highly paid employees of tax-exempt organizations may not actually hit its most valuable target: college coaches.

While it appears that lawmakers intended the tax to apply to all tax-exempt organizations, the law as written may require a technical correction. But not everyone agrees that a correction is necessary, an important factor given that the fate of a technical corrections package remains uncertain.

The Tax Cuts and Jobs Act (P.L. 115-97) created a 21 percent excise tax on exempt organizations for compensation in excess of \$1 million paid to the five highest-paid employees. When tax practitioners discuss the new excise tax, one name inevitably comes up: University of Alabama head football coach Nick Saban. It was widely reported last year that Saban would make \$11.125 million in 2017, and at least \$65 million over the next eight years, following a contract extension.

Many practitioners believe Congress intended the tax to apply to Saban and other highly paid coaches at public universities. The law creates specific exceptions for doctors, nurses, and veterinarians, but doesn't exclude public university employees. Coaches are among the most lucrative potential targets of the tax. According to 2016 data compiled by ESPN, 39 of the highest-paid public employees by state were college football or men's basketball coaches. The Joint Committee on Taxation estimated (JCX-67-17) that the excise tax would bring in \$1.8 billion over 10 years.

Treasury and IRS officials are aware there could be a problem. Janine Cook, IRS deputy associate chief counsel (tax-exempt and government entities), said February 23 at a TE/GE Council meeting in Baltimore that the law as written "does not necessarily cover all public state colleges and universities." Elinor Ramey, an attorney-adviser in the Treasury Office of Tax Legislative Counsel, made similar comments earlier that month, adding that a JCT staffer suggested a technical correction might be needed on the issue.

However, a Senate Finance Committee staffer told Tax Analysts that the tax will apply to all tax-exempt organizations, and that it's the committee's understanding that there's no need for congressional action. Guidance on the new excise tax was included as one of the projects to help implement the TCJA in the updated priority guidance plan.

**'Unlike the tax on unrelated business income, this is a direct tax on their related operations as public universities — and a direct hit on the doctrine of implied statutory immunity,' Lion said.**

Roger Denny of Spencer Fane LLP told Tax Analysts that some public universities are adamant that the law as written doesn't apply to them. Denny's practice focuses on representing athletic directors and university athletic departments.

Carol V. Calhoun of Venable LLP said a technical correction seems like the most straightforward solution, but she's unsure whether a corrections package will get the necessary votes to pass. Lawmakers are already sparring over how to approach corrections, including how long the process should take. Meghan R. Biss of Caplin & Drysdale Chtd. said some practitioners believe the changes that should be made to the excise tax may be too substantive to be dealt with through a technical correction.

Even if a correction is made, that might not be the end of the story. Ofer Lion of Seyfarth Shaw LLP said the bigger question may be whether state universities should or will pay that tax even if a correction makes clear they are covered. "Unlike the tax on unrelated business income, this is a direct tax on their related operations as public universities — and a direct hit on the doctrine of implied statutory immunity — perhaps akin to charging the states an excise tax on compensation to their own governors and attorneys general," Lion said.

### **Congress Fumbles the Ball?**

The debate over whether universities are covered by the excise tax began with a blog post

by Ellen P. Aprill of Loyola Law School, in which she argued that Congress had inadvertently left public universities off the hook. Aprill said the law's reference to section 115(1), which relates to government instrumentalities, was insufficient to bring public universities into the tax's purview. Aprill said it's a common misreading that public universities avoid taxation under section 115(1), but that they're actually exempt from tax under a doctrine of implied statutory immunity because they qualify as an integral part of government or a political subdivision.

However, professor Douglas A. Kahn of the University of Michigan Law School countered in a *Tax Notes* article that the law applies to universities as written. In addition to section 115(1), the excise tax covers organizations exempt under section 501(a), which means section 501(c)(3) organizations are covered. Many public schools have obtained section 501(c)(3) letters for fundraising purposes. Not all universities have one, but Kahn said that doesn't mean they're excluded from the excise tax.

"Section 501(a) exempts from taxation income earned by an organization described in section 501(c)(3)," Kahn told Tax Analysts. "There is no question that a state university is 'described' in section 501(c)(3). It is a corporation organized and operated exclusively for educational purposes." Kahn said he believes state universities are exempt from tax under section 115(1), but that it's not as clear as the case under section 501(c)(3).

Aprill responded to Kahn's arguments in her own *Tax Notes* article, arguing that under section 508, a university must apply for and receive a section 501(c)(3) letter to have section 501(c)(3) status. Therefore, the excise tax wouldn't apply to colleges that don't have a 501(c)(3) letter, she argued.

However, Marcus S. Owens of Loeb & Loeb LLP said a 1978 general counsel memorandum (GCM 37657) seems to indicate that universities, or at least their related income streams, escape taxation by virtue of section 115(1). Notably, Owens said there is no section 508 equivalent regarding section 115(1) mandating that universities come forward and obtain rulings from the IRS.

Some schools have purposely avoided section 501(c)(3) status. For example, the University of

Texas at Austin's website states that the school is not tax exempt under section 501(c)(3). "Rather, the university is exempt because it is a branch of the State of Texas and as such is exempt from federal taxation under the constitutional doctrine of intergovernmental tax immunity," according to the website.

**By referencing section 115(1), Congress has plunged into a legal morass that the IRS has never fully reconciled, Calhoun said.**

Denny said the University of Texas and other schools without a section 501(c)(3) letter insist that the tax won't apply to them absent a technical correction. Biss said some universities may want to give up their section 501(c)(3) letter and rely solely on their governmental entity status if they think it will help them avoid the tax. She noted that the IRS saw an increase in EOs relinquishing their section 501(c)(3) status and relying instead on their governmental immunity following the passage of the Affordable Care Act.

Calhoun said that by referencing section 115(1), Congress has plunged into a legal morass that the IRS has never fully reconciled. She said the existing authority is decidedly mixed on whether a university is a governmental instrumentality subject to section 115(1), or an integral part or subdivision of government and thus constitutionally exempt from tax.

In the absence of technical corrections, Calhoun said the IRS could choose to issue guidance finding that all public universities are governmental instrumentalities, and overrule any existing guidance to the contrary. Given that universities are one of the few types of EOs with employees making more than \$1 million, singling them out as instrumentalities might be practical for the IRS, Calhoun said. But a technical correction would be the cleaner approach, because having the IRS simply declare all universities instrumentalities could further muddy the subject, especially as it relates to other kinds of government entities, she said. Calhoun noted that some universities have private letter rulings declaring them an integral part of government, so those letters would need to be

revoked if the IRS wanted to declare them instrumentalities instead.

### More Monday Morning Quarterbacking

There are also questions about how the new excise tax will interact with the intermediate sanctions regime under section 4958, which imposes a tax on executives at EOs who receive compensation deemed more than "reasonable." Denny said the IRS hasn't imposed the intermediate sanctions regime on public universities even when they have a section 501(c)(3) letter. Denny pointed to a 2013 IRS report on university compliance noting that section 4958 applies to "private, but not public, colleges and universities." However, Denny said he wouldn't expect the IRS to show a similar forbearance regarding the new excise tax.

Another complication is that it's not always the university paying the coach's salary. Denny said some public universities pay their coaches through a separate entity. For example, the University of Florida pays its coaches through a separate section 501(c)(3) nonprofit entity called the University Athletic Association, he said. Such outside organizations can't claim any form of governmental immunity and would fall within the scope of the excise tax.

Denny said that of the 65 schools in the Power Five conferences, 39 either have a section 501(c)(3) letter or pay their coaches through a separate organization, and thus they would likely fall within the scope of the excise tax as written. Regardless of whether the tax applies to universities, practitioners agreed that it wasn't the intent of Congress that the excise tax apply to some public universities and not others based simply on whether they have a section 501(c)(3) letter, and that such a result would be inequitable. "It would be anomalous if they were the only ones hit with the tax," Owens said. ■

*David van den Berg and Fred Stokeld contributed to this article.*