Proskauer

Tax Reform: Focus on the Sports Industry

November 13, 2017

Over the last several days, there have been significant developments relating to the Tax Cuts and Jobs Act, the pending tax reform legislation in Congress.[1] On Thursday, a detailed summary of the Senate Finance Committee's proposal was released (the "Senate Markup"),[2] and the House Ways and Means Committee voted (in a 24-16, party-line vote) to advance their bill for consideration by the full House of Representatives (the "House Bill").[3] This alert describes provisions of the Senate Markup and House Bill that would have the most significant impact on the sports industry, including important differences between the two proposals. Unless otherwise noted, all proposals described below would be effective for taxable years beginning after December 31, 2017.

Repeal of tax-exempt status for professional sports leagues

The Senate Markup proposes to eliminate the tax exemption for professional sports leagues, regardless of size.[4] Since 1966, U.S. tax law has exempted professional football leagues from tax, and the Internal Revenue Service has historically interpreted this exemption to apply to all professional sports leagues. The House Bill does not include a corresponding proposal.

No deduction by employers for entertainment activities

Both the Senate Markup and the House Bill would eliminate the deduction for activities generally considered to be entertainment, amusement or recreation, or a facility or portion thereof used in connection with any of such items. The proposals repeal the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50% limit to such deductions). These proposals could significantly impact sales of suites, premium seats and season tickets purchased by businesses.

Name and logo licensing income for tax-exempts proposed to be taxable UBTI

The Senate Markup proposes to treat royalty income derived from the licensing of a tax-exempt organization's name or logo as unrelated business taxable income ("UBTI") and thus would subject that income to tax at regular corporate income tax rates.[5] Under current law, royalty income generally is excluded from UBTI. This proposal would apply to professional leagues and circuits that are organized as tax-exempt entities, as well as collegiate conferences, universities and national sports federations. The House Bill does not include a proposal on this point.

The Senate Markup also includes a provision requiring the computation of UBTI separately for each separate unrelated trade or business, which (depending on the particular facts) could limit the use of certain unrelated trade or business losses to offset income from name or logo licensing.

No tax-exempt bonds for professional stadiums

The House Bill proposes the imposition of tax on interest on bonds issued to finance the construction of, or capital expenditures for, a professional sports stadium (defined as any facility that is used as a stadium or arena for professional sports exhibitions, games or training for at least five days in any calendar year). The provision would be effective for bonds issued after November 2, 2017. The Senate Markup does not include such a proposal.

Expansion of excise tax on tax-exempt organizations and certain highly-compensated employees (*e.g.*, athletic coaches)

The Senate Markup and House Bill both expand the existing provisions governing excess benefit transactions ("intermediate sanctions") for tax-exempt organizations, which result from having certain highly-paid employees. Both proposals would impose a 20% excise tax on compensation of more than $1 million paid by any tax-exempt organization to any of its top-five highest compensated employees (including all wages and most benefits).[6] This new rule effectively parallels the existing $1 million deductibility limitation for executive compensation paid by publicly traded companies. Notably, athletic coaches at educational institutions, as well as commissioners and other senior executives of other tax-exempt sports entities, would potentially be included among the affected employees.

In addition, the Senate Markup would explicitly classify athletic coaches at most institutions of higher education as disqualified persons who are personally subject to draconian penalties on excess benefit payments (an initial tax of 25%, which increases to 200% if not corrected during the taxable period) where the tax-exempt organization makes payments that are deemed to exceed the value of the services provided by the disqualified person. This proposal would also impose a new 10% excise tax on the tax-exempt organization itself in respect of such transactions. The House Bill does not include this reclassification proposal or the 10% excise tax.

No deduction for amounts paid in exchange for college athletic seating rights

The Senate Markup and the House Bill both propose that no charitable deduction be allowed for any payment made to an institution of higher education in exchange for the right to purchase tickets or seating for athletic events. These proposals effectively repeal the existing special rule that allows the purchaser to take a charitable deduction of 80% of the amount paid for the right to purchase the tickets.

Excise tax on net investment income of private colleges and universities

The Senate Markup and House Bill both propose a 1.4% excise tax on the annual net investment income of private institutions of higher education that have assets with an aggregate fair market value of at least $250,000 per student (other than those assets which are used directly in carrying out the institution's exempt purpose) and at least 500 tuition-paying students. This new rule would effectively parallel the existing excise tax on the net investment income of private foundations.

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The ultimate enactment of U.S. tax reform will require the adoption of identical bills by both the House and Senate, and the signature of the President. Any reconciliation of the two bills will require significant negotiation between the two chambers, unless the House were to adopt the bill passed by the Senate. As a result, the precise form that tax reform legislation will take, if and when it is ultimately enacted, remains highly uncertain. However, Republican leadership has consistently maintained that they will present legislation to the President for his signature by year's end. Therefore, taxpayers should consider the effects of the proposals in the House Bill and the Senate Markup, and plan accordingly. Please contact your usual Proskauer contact, or any member of the Proskauer Tax Department, to discuss any of these issues.

[1] Tax Cuts and Jobs Act, H.R. 1, as reported by the House Committee on Ways & Means to the House Rules Committee, Nov. 10, 2017.

[2] Joint Committee on Taxation, Description of the Chairman's Mark of the "Tax Cuts and Jobs Act" as reported by the Senate Finance Committee, Nov. 9, 2017.

[3] Amendment to the Amendment in the Nature of a Substitute to H.R. 1, the "Tax Cuts and Jobs Act," Nov. 9, 2017.

[4] Previously, the *Properly Reducing Overexemptions for Sports Act* (the "PRO Sports Act"), which was sponsored by Representatives Matt Gaetz (R-FL) and Blake Farenthold (R-TX) but never enacted, proposed repealing this exemption only for professional sports leagues, organizations or associations with annual gross receipts in excess of $10 million.

[5] Both the House Bill and Senate Markup propose reducing the corporate income tax rate from 35% to 20%, although the Senate Markup would delay rate reduction until 2019.

[6] Payments to a tax-qualified retirement plan and amounts that are excluded from gross income would not be included for this purpose under the proposals.

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