

Intellectual Property and  
Nonprofit & Religious Organizations  
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## Path Narrows for Nonprofit Status for NIL Collectives



While the rules for compensation to student-athletes for their name, image and likeness (NIL) continue to evolve, the Internal Revenue Service (IRS) roundly rejected the ability of NIL collectives to uniformly qualify for nonprofit status in a General Legal Advice Memorandum (GLAM) last month. The initial formation of NIL collectives, some in connection with the schools and others independent of them, developed after the National Collegiate Athletic Association (NCAA) authorized the compensation of student-athletes and established rules on third-party agreements on compensation. Of these NIL collectives, dozens sought or obtained nonprofit status, which allows them to raise funds exempt from taxation and provide donors with a charitable deduction for their contributions. The new GLAM, while not a legal precedent, does signal a new framework for NIL collectives and donor-funded NIL activities.

The memorandum states that “an organization that develops paid NIL opportunities for student-athletes will, in many cases, be operating for a substantial nonexempt purpose – serving the private interests of student-athletes – which is more than incidental to any exempt purpose furthered by the activity.” In determining that NIL collectives do not qualify for tax exemption, the IRS emphasized that the organization’s private benefit is clearly not incidental, either qualitatively or quantitatively, to the overriding public interest for several reasons.

Collectives generate funds from revenue raised through a vast pool of resources, including boosters, businesses and fans. Collectives use the funds to assist student-athletes in leveraging their NIL in exchange for compensation and can increase in size exponentially, competing with the schools themselves, if they can offer tax-deductible donations. For-profit NIL collectives, typically registered as limited liability companies (LLCs), may offer student-athletes NIL opportunities using any compensation structure but may face restrictions on raising funds for the compensation based on their taxable income and contributions that are not broadly deductible. Collectives with nonprofit status, however, could be tax-exempt and provide charitable deductions but must qualify as Section 501(c)(3) public charities, which by definition exclusively further one or more exempt purposes, such as charitable, religious, [and] educational purposes.

The nonprofit benefits come with the tradeoff of being subject to compliance with tax-exempt regulations, such as being subject to restrictions on serving public purposes with no more than an incidental private benefit and potentially being subject to determinations of whether compensation paid to student-athletes is reasonable. In determining the collectives’ compliance, the new GLAM addressed

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whether the NIL collective activities truly further an exempt purpose under Section 501(c)(3) and benefit the public more than serving any private interest.

The IRS found that the collectives do not comply with tax-exempt regulations, as the individual student-athletes are the primary beneficiaries of activities that are not necessary to the promotion and marketing of charitable causes. As the primary beneficiaries, student-athletes receive direct compensation, financial planning, tax assistance, legal advice and assistance in personal branding. The IRS also found that this nonexempt purpose was substantial in amount when compared to the overall public benefit of NIL activities. The IRS stated, “Student-athletes generally benefit from a nonprofit NIL collective through the compensation paid by the collective for the use of their NIL. This private benefit is not a byproduct but is rather a fundamental part of a nonprofit NIL collective’s activities.”

What is the practical effect on prospective and current student-athletes, institutions and future collectives? Notably, the bigger implications for all parties will be determined on a state-by-state basis, as some states have enacted NIL legislation or amended its regulations, whereas other states have yet to propose any NIL legislation. But at the federal level, the IRS has closed the door on the more basic attempts to cast NIL collectives as nonprofits and, in public remarks, noted that it may consider revoking the exemption of those collectives that have already received nonprofit status.

NIL collectives looking to qualify for or retain their nonprofit status will need to give more careful thought to how they satisfy the exemption criteria. One approach could be to restrict funds to educational purposes like books, on-campus housing and tutoring. Nonprofit collectives could even consider whether payments might be attached to educational achievement, financial need or other criteria that track established exempt purposes more closely. It will be important that all parties to a NIL agreement continue to monitor the enforcement and compliance of NIL rules and regulations. Meanwhile, individuals or entities seeking to create, contribute to or benefit from NIL collectives should consult with their attorney before and after an official ruling.

Prospective and current student-athletes should consult with an attorney before pursuing any NIL opportunities. The right to license and receive compensation from one’s NIL is commonly known as the “right of publicity.” This right prohibits businesses, schools and so forth from various unauthorized uses of a person’s NIL. As a valuable property, NIL can be advantageous for student-athletes. Yet, if collectives are granted the right to use their NIL (e.g., in beverage commercials and video games), student-athletes may expose themselves to liability or unauthorized exploitation.

The unauthorized use of NIL is knowingly using another’s name, voice, signature, photograph or likeness in any manner, on or in products, merchandise or goods or for purposes of advertising or selling or soliciting purchases, without such person’s prior consent. However, with various state-level NIL laws, the enforcement of and compliance with various rules make up a demanding process for student-athletes. Prospective student-athletes should consult state laws and rules when choosing the school they wish to attend, given the distinctions between high school NIL policies and prospective collegiate policies.

An additional hurdle for student-athletes is the NCAA transfer portal. The portal, created by the NCAA on Oct. 15, 2018, is an online database that manages and facilitates the process for student-athletes seeking to transfer between member institutions. Regardless of the evolving nature of NIL, colleges and universities will expect transfer student-athletes to comply with all current NIL laws and university rules and regulations. Currently, student-athletes must adhere to the NCAA’s NIL Policy Guidance and

to reporting requirements related to compensation. Student-athletes who receive compensation from organizations under a NIL contract will be issued Form 1099s for any amount totaling \$600 or more. Despite the NCAA's policy allowing student-athletes to monetize their NIL, student-athletes should take care to protect their personal brand and eligibility while capitalizing on NIL opportunities.

Likewise, institutions, and their respective coaches and staff, should consult the NCAA's guidance on boosters, NIL collectives and prospective student-athletes when endorsing NIL opportunities. The NCAA's guidance clarifies that schools may not use NIL transactions to compensate student-athletes for athletic participation or improper inducement. But the NCAA's guidance on institutional involvement with current student-athletes as compared to prospective student-athletes is ambiguous. It is paramount that institutions comply with the NCAA Division I Bylaws and the NCAA Interim Policy while surveying the state laws that the NCAA's guidance is subject to. Because of these varied authorities, institutions should consult legal counsel regarding issues that may stem from involvement with NIL activities and collectives.



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