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The Connection

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Tax issues with name, image and likeness monetization by student athletes

For many years, the rules of the National Collegiate Athletic Association (NCAA) prohibited college athletes from making money on their name, image and likeness (NIL). However, the Supreme Court ruled in June 2021 that student athletes can be compensated for their NIL. The court action was initiated by legislation California enacted in 2019 allowing college athletes to be paid for their NIL. After the ruling, other states followed California's lead.

In 2021, the NCAA revised its guidelines to allow NIL payments under certain rules. Some of the new state legislation conflicted with these new NCAA guidelines. The NCAA has encouraged Congress to standardize the approach to monetization of NIL, but no such federal legislation has yet been enacted.

Some tax issues have arisen around the monetization of NIL. Income received from NIL monetization is taxable, and the student athletes are viewed as independent contractors earning money separately from their colleges and universities. For many of these student athletes, this may be their first exposure to needing to file tax returns or filing as an independent contractor, with issues such as completing Form 1040 and 1040 Schedule C, paying self-employment taxes and paying estimated taxes. They also must follow the guidelines of the NCAA and their state NIL statute and proceed carefully when those conflict.

Organizations called collectives have been organized to support the efforts of student athletes at specific educational institutions to set up NIL arrangements. Whether some of these organizations are for-profit entities or can qualify for not-for-profit status remains unclear. To attract donations from individuals who would otherwise donate directly to the college or university, many collectives may feel pressure to offer a charitable deduction to the donors. A competition has developed to help attract the best athletes by offering the best NIL opportunities, and some student athletes have factored NIL programs into their school choice. This competition will continue to affect the development of these collectives.

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College athletes

College athletes can earn income from NIL in many ways, including endorsements of products or services, appearances at business or charitable events, social media posts, autograph fees, or goods and apparel. Income from all these sources is taxable income reportable on the students' or parents' federal and possibly state and local tax returns. The state and local tax returns required may depend on where the NIL activities took place. College athletes in all states can earn income from NIL in line with NCAA guidelines. More than half of the states have adopted their own NIL legislation. Some purport to prohibit the NCAA from enforcing any restrictions in conflict with the state legislation. Unless federal legislation is enacted, college athletes will need to tread carefully between differing state and NCAA rules. There may be limits to how much help a school can give an athlete with their tax obligations. There should at least be the possibility of referring student athletes to outside tax assistance resources.

Among the concerns college athletes will face is having the cash to pay the income taxes and estimated taxes due, especially if much of the NIL income is not in the form of cash but of products or services. The student athlete may receive 1099 forms from NIL providers that must be reflected on their tax returns. They will be responsible not only for income taxes but also self-employment taxes. NIL activities may also affect their eligibility for scholarships or other financial aid for tuition and fees.

High school athletes

About half of the states have NIL legislation that also makes it possible for high school athletes to earn NIL. Although the NIL opportunities are probably not as large, these athletes are likely to be even more inexperienced and have less advice and direction from a school. Typically, a high school athlete cannot promote their connection to a team, school or district. While outside NCAA jurisdiction, the ability to preserve amateur status may also be an issue in some states. These students are less likely to have an organization to help present them with NIL opportunities and are more likely to need professional advice on NIL activities and tax rules.

NIL collectives

Supporters of a particular college or university may set up an independent NIL collective to solicit donations and identify NIL opportunities for the school's student athletes. These collectives have become popular to help student athletes maximize their NIL potential and in turn attract top athletes to the school. To help attract donors, some collectives have sought tax-exempt status so their donors can receive a charitable tax deduction, just as if they made the donation directly to the school.

While some collectives appear to have been granted tax-exempt status by the IRS, an IRS memorandum in May 2023 called into question whether these collectives should be eligible for tax-exempt status on the basis that private benefits provided to student athletes are not an exempt purpose under the Internal Revenue Code. If tax-exempt status is not available, donors may be less inclined to fund these collectives.

The NCAA

The revised NCAA NIL rules, while permitting college athletes to receive income from NIL activities, still try to prohibit earnings that look like pay to play at a school. The guidelines address permissible and impermissible activities of the college or university. The NCAA appears to have taken the position that schools under their jurisdiction must comply with NCAA NIL policies even if a state NIL statute appears to prohibit the NCAA from enforcing policies in conflict with state law. The NCAA is pushing for federal NIL legislation to help resolve the various conflicting rules in state statutes. In the meantime, student athletes may want to stay in compliance with both NCAA and state NIL rules.

Individual failed to substantiate certain business expenses

Due to lack of substantiation, an individual was not entitled to deduct certain business expenses reported on Schedule C. The taxpayer failed to meet the strict substantiation requirements under Code Sec. 274. The bank records submitted did not substantiate the disallowed deduction for contractors. The profit and loss statements were unreliable and insufficient to demonstrate error in the IRS' determinations. The taxpayer did not have any of the supporting documentation other than the bank statements used to prepare the profit and loss statements. Accordingly, the determinations regarding the Schedule C deductions claimed by the taxpayer were sustained (*C.R. Pangelina*, TC Memo. 2024-5, Dec. 62,406(M)).

Further, the taxpayer had unreported gross income for one of the tax years at issue. The taxpayer did not dispute that he received gross receipts for that tax year, and in his unsigned return he reported that his sole proprietorship had gross receipts. Additionally, the taxpayer failed to support his claims on the unsigned return that he was entitled to head of household filing status, dependency exemptions for three children, the additional child tax credit or the earned income credit. Moreover, the taxpayer did not dispute that he received unreported taxable interest income for three of the tax years at issue. Accordingly, the IRS' determinations were sustained.

Accuracy-related penalties

The taxpayer was liable for accuracy-related penalties under Code Sec. 6662(a). The IRS secured supervisory approval before the notice of deficiency was issued to the taxpayer. Further, the taxpayer did not show he had reasonable cause for the understatements or otherwise address the accuracy-related penalties.

Additions to tax

The taxpayer was liable for additions to tax under Code Sec. 6651(a)(1) for failure to timely file his return. For each tax year at issue, the taxpayer failed to file until more than five months after the due dates for the returns.

"For each tax year at issue, the taxpayer failed to file until more than five months after the due dates for the returns."

Further, the taxpayer did not show that his failure was due to reasonable cause. Additionally, the taxpayer was liable for additions to tax under Code Sec. 6651(a)(2) for failure to timely pay tax for one of the tax years at issue. The taxpayer did not show reasonable cause for the failure to pay the tax.

Married couple withheld discoverable information

In a recent case, the government's motions to compel, for sanctions and to confirm stay of dispositive motion deadline in light of a pending discovery motion were granted. The parties' main dispute was whether the 10-year statute of limitations governing the collection of unpaid taxes had expired under Code Sec. 6502(a). The taxpayers argued that the government's motion should have been denied because the requested relief was unnecessary or not found in the federal discovery statute. The district court concluded the taxpayers' responses were inadequate.

Their responses were incomplete and evasive because they did not answer the call of the question presented in each interrogatory. Interrogatories 3, 4 and 5 each asked the taxpayers to provide facts, but the bulk of each answer only provided the taxpayers' opinion that the IRS' records were unreliable. Accordingly, the district court ordered them to clarify their answers to 3, 4 and 5 within thirty days of this order and resubmit separate answers to the government (*D.R. Wildish*, DC Ida).

The government also subpoenaed the taxpayers' former CPA for related communications with the IRS, but the taxpayers instructed him not to respond on the basis that any information was covered by attorney-client privilege.

> "The taxpayers contended a privilege log was unnecessary because they produced the sole document they initially claimed was privileged."

However, the taxpayers no longer appeared to argue that any information they were withholding was privileged. The taxpayers contended a privilege log was unnecessary because they produced the sole document they initially claimed was privileged. Accordingly, there was no longer any basis for the taxpayers not to allow their former CPA to produce the documents the government requested.

Additionally, the government requested the district court to allow the husband's deposition. The husband abandoned his deposition, claiming he needed time to make a motion. However, he had made no motion to terminate or limit his deposition. Moreover, the taxpayers had made no attempt to explain why they abandoned the deposition. Accordingly, the district court permitted the government to continue its deposition, and the taxpayers were required to pay the reasonable expenses incurred by the government to do so. Finally, the district court found that good cause existed to extend the dispositive motion deadline. The taxpayers had withheld discoverable information pertinent to determining the main issue in this case regarding the statute of limitations. ■

Corporate bond yield curve for present value calculations in defined benefit plans

The IRS issued final regulations that specify how to construct the corporate bond yield curve used to derive the interest rates for present value calculations under defined benefit plans (T.D. 9986). These calculations are necessary to determine the plan's minimum required contribution and the present value of annuity benefits. Insurance companies also use the calculations to discount unpaid losses and estimated salvage recoverable. The rules apply to determinations of the corporate bond yield curve for months that begin on or after Feb. 1, 2024.

Defined benefit plans that are not multi-employer plans must meet the minimum funding requirements of Code Sec. 430. To do so, plans must calculate the present value of benefits using three interest rates: the first segment rate for benefits payable within five years of the valuation date, the second segment rate for benefits payable within the next 15 years and the third segment rate for benefits payable after 15 years. Under Code Sec. 430(h)(2)(C), each segment rate is determined for a month based on the corporate bond yield curve for the month, subject to interest rate stabilization rules. Plan sponsors may also elect to use the corporate bond yield curve instead of the three segment rates to determine the plan's minimum required contribution. Monthly IRS notices set the corporate bond yield and the segment rates for the month.

> "Insurance companies also use the calculations to discount unpaid losses and estimated salvage recoverable."

The final regulations generally adopt the regulations proposed on June 23, 2023. They provide a methodology for determining the corporate bond yield curve that is generally the same as the current one, with two changes:

- An additional adjustment factor that takes into account a "hump adjustment variable" that peaks at 20 years maturity
- A narrower exclusion from the bond data set for callable bonds

The regulations also reflect the interest rate stabilization rules and eliminate transition rules that applied to plan years beginning before 2010. ■

IRS initial guidance for pension-linked emergency savings accounts

As directed by the SECURE 2.0 Act of 2022 (P.L. 117-328), the IRS issued initial guidance to help employers setting up pension-linked emergency savings accounts (PLESAs). Specifically, the IRS addressed reasonable anti-abuse procedures under Code Sec. 402A(e)(12) to prevent participants from manipulating the rules of the plan so matching contributions exceed the intended amounts or frequency (Notice 2024-22, IR-2024-11).

Background

Employers can offer PLESAs in plan years beginning after Dec. 31, 2023. In general, PLESAs are short-term savings accounts established and maintained in connection with a defined contribution plan and are treated as a type of designated Roth account. Subject to certain restrictions, matching contributions are made at the same rate as contributions to the linked defined contribution plan.

Anti-abuse procedures

The IRS indicated a plan sponsor could reasonably view the statutory restrictions on PLESA participants as sufficient anti-abuse provisions. For example, a plan sponsor might reasonably consider a participant as not manipulating the matching contribution rules if they made a $2,500 contribution in one year, received the matching contribution, then took $2,500 in distributions that year and repeated the pattern in subsequent years. Similarly, a plan sponsor could limit the number of permissible withdrawals to one per month as an anti-abuse rule.

The IRS also listed examples of procedures that are unreasonable to implement:

- A plan may not provide for the forfeiture of matching contributions that were already made.
- A plan may not suspend a participant's ability to contribute to the PLESA due to a withdrawal.
- A plan may not suspend matching contributions on the participant's contributions to the underlying defined contribution plan.

IRS reminds employers about SECURE Act changes to 401(k) eligibility

The IRS has reminded employers about changes the SECURE Act made regarding 401(k) plan eligibility. Previously, plans could require a year of service or three consecutive 12-month periods during which the employee was credited with at least 500 hours of service.

Starting in 2025, the three-year condition for long-term part-time employees will be reduced to two years. This applies to all 401(k) plans, excluding certain employees under collective bargaining agreements. For plans using the calendar year, enrollment adjustments may be needed by Jan. 1, 2024. Employers should review census data, identify long-term part-time employees and correct any missed deferral opportunities through the Employee Plans Compliance Resolution System.

Action items to avoid long-term part-time errors:

- **Review census data:** Examine census data for employees ineligible for the 401(k) plan due to not completing a year of service per plan terms.
- **Identify eligible employees:** Identify employees age 21 or older who have completed more than 500 hours of service in three consecutive 12-month periods since 2021.
- **Consider employee class:** Employees in classes not based on service and excluded under the plan are not required to be included in the plan as long-term part-time employees until they are in an eligible class.
- **Evaluate exclusions:** Avoid impermissible exclusions based on "part-time" or "seasonal" status. Include eligible employees meeting long-term part-time criteria.
- **Offer deferral opportunities:** Confirm every long-term part-time employee has been promptly offered the opportunity to make salary deferrals to the plan.

Individual's late-filed Form 1040 qualified as return

The Form 1040 submitted by an individual was a return for purposes of allowing a summary assessment by the IRS under Code Sec. 6201(a) (J.E. Cortez, DC Calif). The IRS assessed tax against the taxpayer individually for the tax year at issue pursuant to a substitute return the IRS prepared on the taxpayer's behalf under Code Sec. 6020(b). The additional assessment was made through a summary assessment pursuant to Code Sec. 6201(a)(1) because the taxpayer and his wife later reported more tax due in their Form 1040 than the IRS had initially calculated in its substitute return. The taxpayer contended that because the filing of Form 1040 was late, it did not constitute a return. The IRS contended that the assessment at issue was proper because the taxpayer's filing of the Form 1040 constituted a return under Code Sec. 6201(a)(1) and therefore the taxpayer was not entitled to a refund.

The district court concluded that various provisions in the Code supported the conclusion that a late-filed Form 1040 can be considered a return, thus allowing the IRS to make a summary assessment. Additionally, the taxpayer's Form 1040 met all the requirements of the test in *Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986), to qualify as a return. The document purported to be a return, could be executed under penalty of perjury, contained sufficient data to allow calculation of tax and represented an honest and reasonable attempt to satisfy the requirements of the tax law. ■

Procedure updated to request extensions for employee benefit plan filings

Starting in 2024, Form 5558 is no longer used to request a time extension to file Form 5330, *Return of Excise Taxes Related to Employee Benefit Plans*. Instead, filers must use Form 8868, *Application for Extension of Time to File an Exempt Organization Return or Excise Taxes Related to Employee Benefit Plans*.

Form 5558 is still used to request an extension to file a Form 5500 series or Form 8955-SSA. The IRS had previously anticipated that Form 5558 could be filed electronically for the 2023 filing season. However, due to administrative issues involving the EFAST2 system, the IRS is postponing electronic filing of Form 5558 until Jan. 1, 2025. Plan sponsors and administrators should continue to use a paper Form 5558 to request a one-time extension of up to 2½ months after the normal due date to file a Form 5500 series or Form 8955-SSA. ■

Building a team of professionals to help provide solutions for our clients

At Edward Jones, we believe that when it comes to financial matters, the value of professional advice cannot be overestimated. In fact, in most situations we recommend that clients assemble a team of professionals to provide guidance regarding their financial affairs: an attorney, a tax professional and a financial advisor.

We want to work together as a team and offer value for your practice and clients. Using complementary skills and philosophies, we can help save time, money and resources while assisting mutual clients in planning for today's financial and tax challenges.

The 2024-2025 All-Star Tax Series schedule

Date	Course topic
May 8 & 15, 2024	Implementing the Corporate Transparency Act
June 5 & 13, 2024	Understanding health savings accounts
June 18 & 26, 2024	Issues and challenges related to S corporations and partnerships
July 17 & 25, 2024	Critical issues relating to IRAs and retirement accounts
Aug. 7 & 15, 2024	How tax practitioners can effectively represent clients under audit by the IRS
Aug. 21 & 27, 2024	What tax practitioners need to know about purchasing and selling a business
Sept. 18 & 25, 2024	What tax practitioners need to know regarding Medicare and Social Security
Oct. 23 & 29, 2024	Tax issues associated with the purchase and sale of a residence
Nov. 6 & 12, 2024	Tax issues relating to the gig economy
Nov. 20 & 26, 2024	Individual tax update and planning strategies
Dec. 11 & 18, 2024	Business tax update and planning strategies
Jan. 15 & 23, 2025	Getting ready for tax season: New IRS forms and compliance requirements

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