



STATE INCOME TAXATION OF STATE UNIVERSITIES

A framework for analysis.

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State universities (defined in this article as integral parts of the state, as opposed to state-owned 501(c)(3) organizations operating as universities) are taxed under a unique set of applicable laws. Most notably, their federal income tax exemption is derived not from a specific exemption in the Internal Revenue Code, or IRC, but rather they are not subject to tax in the first place based on the “doctrine of inter-governmental immunity.” The doctrine of inter-governmental immunity was developed by the U.S. Supreme Court based on the supremacy clause, the 10th Amendment, and the preservation of federalism.¹ At the same time, state universities are subject to federal income tax on their unrelated business taxable income, or UBTI, pursuant to IRC § 511(a)(2)(B). Over the years, the federal taxation of such state universities has been refined and clarified into a fairly predictable set of rules. However, state income tax laws are often not so clear cut and create a host of ambiguities and potential compliance risks that representatives of such entities must be prepared for.

Below, this article outlines a three-step framework for the analysis of taxability as many state codes differ significantly in form and terminology, or even the existence of applicable taxes at all (see South Dakota and Wyoming, which do not have corporate income taxes). Then an example of the framework applied to a state, using Florida as an example, follows.

Step 1: Search for an income tax imposition statute. Without a statute imposing tax, there is no tax owed and the analysis can end. Commonly, the tax potentially applicable to a state university is a “corporate tax.” Sometimes, it is called a “franchise tax.” Sometimes the imposition statute follows a similar pattern to federal law and imposes tax only within a UBTI statute.

Step 2: Once you find the potentially applicable statute, look at the definitions applicable to the statute at issue. Many states, for example, might have an imposition statute that taxes “corporations” defined in a way that excludes foreign state governments. Sometimes, the UBTI statute only applies to “501(c)(3) organizations,” which means a state university that is not a 501(c)(3) would escape taxation.

Step 3: If a tax appears to apply, search for various exceptions to the tax.

One potential grey area is when an imposition statute is broadly worded to cover all income with no exemption. In that case, non-UBTI income should still be exempted under the doctrine of intergovernmental immunity, but this may be a source of litigation.

Example: Florida

Florida has a relatively clear set of statutes and taxes UBTI similar to the federal model. The imposition statute² imposes tax on the “net income” of “taxpayers.”

The term “taxpayers” is defined to include “corporations,” which includes “all other organizations, associations, legal entities, and artificial persons which are created by or pursuant to the statutes of this state, the United States, or any other state, territory, possession, or jurisdiction.”³ That definition of corporation is likely expansive enough to cover state universities as they are generally legal entities created pursuant to a state statute, and accordingly the imposition statute would apply.

“Net income” is further defined, in Fla. Stat. Ann. § 220.12, as “adjusted federal income.” Adjusted federal income is then defined in Fla. Stat. Ann. § 220.13 (West) differently for various entities, but the one applicable to state universities would be Fla. Stat. Ann. § 220.13(2)(l):

“Taxable income,” in the case of a taxpayer whose taxable income is not otherwise defined in this subsection, means the sum of amounts to which a tax rate specified in s. 11 of the Internal Revenue Code plus the amount to which a tax rate specified in s. 1201(a)(2) of the Internal Revenue Code are applied for federal income tax purposes.⁴

Section 11 of the IRC is corporate taxes and the income of a state university subject to those taxes is generally UBTI. Going through the exercise reveals that the state of Florida imposes a tax on only the UBTI of state universities. **TBJ**

NOTES

1. GCM 14407, C.B. XIV-1, 103 (1935), superseded by, Rev. Rul. 71-131.
2. Fla. Stat. Ann. § 220.11 (West).
3. Fla. Stat. Ann. § 220.03 (West).
4. Fla. Stat. Ann. § 220.13 (West).



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