

Investment credit; section 38 property; unrelated trade or business. Property used predominantly in an unrelated trade or business of a college or university that is both an instrumentality of a state and an organization exempt from tax under section 501(c)(3) of the Code is not excluded from the definition of section 38 property by either section 48(a)(4) or (a)(5) when the income from the unrelated trade or business is subject to tax under section 511.

ISSUE

Is property used predominantly in an unrelated trade or business of a college or university that is both an instrumentality of a state and an organization exempt from tax under section 501(c)(3) of the Internal Revenue Code excluded from the definition of section 38 property by either section 48(a)(4) or 48(a)(5) when the income from the unrelated trade or business is subject to tax under section 511?

FACTS

X, a state university governed by a state board of regents, is also an instrumentality of a state. X is also an exempt organization under section 501(c)(3) of the Code. X operates a commercial television station in addition to its teaching functions. The income X earns from the operation of the television station is unrelated business income taxable under section 511. The property used in connection with the operation of the television station is property otherwise qualified for the investment tax credit.

LAW AND ANALYSIS

Section 38 of the Code allows a credit against federal income taxes for qualified investment in depreciable property ('section 38 property') described in section 48(a).

Section 48(a)(4) of the Code provides that property used by an exempt organization is treated as section 38 property only if the property is used predominantly in an unrelated trade or business the income of which is subject to tax under section 511.

Section 48(a)(5) of the Code provides that property used by the United States, any state or political subdivision thereof, any international organization, or any agency or instrumentality of any of the foregoing shall not be treated as section 38 property.

Section 511(a)(2)(B) of the Code imposes a tax on the unrelated trade or business income of any college or university that is an instrumentality of any government or any political subdivision thereof. The objective in enacting section

511(a)(2)(B) of the Code was to tax public colleges and universities in the same manner as private colleges and universities to the extent they engaged in an unrelated trade or business. See S. Rep. No. 781, Part 2, 82d Cong., 1st Sess. 57-58 (1951), 1951-2 C.B. 545, 584-585.

This section reflects a determination by Congress that public colleges and universities and private colleges and universities should be treated similarly, when engaged in an unrelated trade or business. In effect, a state college or university engaged in an unrelated trade or business is treated under section 511 as a private tax-exempt organization engaged in an unrelated trade or business rather than as a governmental unit or an agency or instrumentality thereof.

Similarly, for purposes of sections 48(a)(4) and 48(a)(5) of the Code, a state college or university engaging in an unrelated trade or business should be treated as a private tax-exempt organization engaged in an unrelated trade or business rather than as a governmental unit or an agency or instrumentality thereof. The investment tax credit provisions were enacted to stimulate investment in depreciable machinery and equipment. Property used by a governmental unit or an instrumentality was excluded from the definition of section 38 property under section 48(a)(5) because allowing the credit for this property was not expected to increase the use of this property by governmental units. H.R. Rep. No. 1447, 87th Cong. 2d Sess. 7, 12, 1962-3 C.B. 405, 416. Treating a state college or university engaged in an unrelated trade or business as a private entity rather than as a governmental unit or an agency or instrumentality thereof is not inconsistent with this rationale. It can be expected that allowing the investment tax credit for property used by a state college or university in an activity that is subject to the tax on unrelated trade or business income will increase investment in that property. Moreover, this treatment is consistent with the Congressional determination embodied in section 511(a)(2)(B).

HOLDING

A state college or university will not be treated as an instrumentality of the state for purposes of section 48(a)(5) of the Code to the extent it engages in an unrelated trade or business the income of which is subject to tax under section 511. Therefore, property used predominantly in an unrelated trade or business of a state college or university is not excluded from the definition of section 38 property by either section 48(a)(4) or 48(a)(5).