ASSOCIATION OF AMERICAN UNIVERSITIES

Report of the Committee on Financial Support and Taxation

The Committee met in New York on January 30, 1950, and on April 23, 1950. The following members were present: Presidents Darden (first meeting only), Dodds, Killian, Painter, and Stassen. Chancellor Hutchins was absent from both meetings. A preliminary draft was circulated among the members of the Association. The comments received have been carefully considered by the committee.

The members present unanimously reached the following conclusions and recommendations:

(1) The financial stability of our universities is dependent upon their being exempt from taxation on income or property used for educational purposes. Any impairment of the long-standing principle of tax exemption would be a fatal blow to our educational system. The critical need at the present time is for positive measures to conserve and increase the income and resources of these institutions if they are adequately to meet the educational needs of the nation. Instead of efforts to tax these institutions we need through government tax policy to protect their resources and to stimulate their support through private philanthropy.

The Committee believes that the Association of American Universities should mobilize its forces vigorously to defend the tax exemption principle and to support changes in the revenue laws which would encourage private philanthropy.

(2) The Committee believes that it would be wise for our educational institutions to refrain from engaging in various types of transactions. These are often referred to by those who seek to impair the tax exemption as furnishing a basis for taxation.
(3) The Committee believes that in addition to investing its funds, it is proper for an educational institution to carry on a variety of other activities which primarily serve its students and members. Such activities aid the educational objectives of the institution and cannot properly be distinguished from the over-all operations of the institution. The Committee believes that it is impractical, if not impossible, to segregate these activities. If the educational institution is to continue to be exempt from income tax, it must be wholly exempt from such taxes, and any effort to tax one part and not another places in jeopardy the whole principle of tax exemption.

The Ownership and Operation of Business and Commercial Enterprises

(4) The Committee believes, however, that a different situation arises when a manufacturing or mercantile business is carried on by a separate corporation or trust which would certainly not be entitled to tax exemption if all its property and income were not dedicated to some university and when such manufacturing or commercial business has no significant connection with the educational or scientific work of the university other than the attribute of producing income for the university.

The Committee believes that it is sound policy for a university not to seek tax exemption for such a separate entity; and not to enter into a transaction involving such a separate entity if the advantage of the transaction depends upon the separate entity being free of federal income tax.

The conditions of the preceding paragraph being satisfied, the University should then continue to be free from income tax on the dividends or other distributions of income by such separate entity just as the University is free from income tax on other income.

The Committee believes that the taxation of such separate entities would cover practically all the business investments which have been subject to
criticism. Few boards of trustees of a university would be willing to accept the liability which would be involved if such business enterprises were to be owned directly by the university, rather than by a separate corporation or foundation. If there should be any change in the revenue laws designed to tax such business operations, it should not be aimed at the university which receives income from the separate entity. Any effort to tax the university or some part of it would violate the tax exemption principle.

(5) Although the Committee believes that a university should not be subject to tax on any earnings which it may derive from an operation carried on directly by the university, nevertheless the Committee believes it is neither proper nor in the public interest for a university to carry on directly any manufacturing or mercantile business having no significant connection with the educational or scientific work of the university other than the attribute of producing income for it.

The Committee believes that an educational institution should continue to be free from income tax on rents and royalties from its interests in real estate.

**Lease-Backs**

(6) There has been criticism of transactions in which an educational institution has directly or indirectly bought a business plant and leased it back to the seller. The Committee believes that many such transactions are unobjectionable. It may often be wise for a company to sell its plant to acquire cash and the sale may not be possible unless the seller leases back the plant either because the seller needs occupancy for a period or because no buyer would pay the price if the plant had no tenant. There is no more objection to a university than to anyone else becoming the owner of such a plant. The exemption of the university from income tax on the rental received does not differ from its exemption from income tax on dividends or on rentals from other real estate.
Any sound basis for criticism must rest on some special aspect of the particular transaction other than the tax-exempt status of the buyer.

To avoid jeopardizing the larger interests involved, the Committee believes that it is wise for a university to refrain from purchasing property directly or indirectly in a transaction in which such property, or the real estate portion thereof, is to be leased back to the seller with an option in the seller to repurchase the property; and that it is also wise to refrain from directly or indirectly making such a purchase and lease-back in a transaction in which the university supplies no substantial part of the purchase price from its funds other than funds received in the transaction or from money borrowed on the specific transaction.

Encouraging Philanthropy

(7) The Committee believes that the Association should take such action as it deems appropriate to secure a change in the Federal income tax law permitting the deductible charitable gifts of an individual in any year to be free of the present 15% limit.

(8) The Committee urges that universities take such action as they deem appropriate to secure the enactment by various states of amendments to their corporation laws authorizing business corporations to make charitable donations.

(9) The Committee believes that universities should take such action as they deem appropriate to obtain an amendment of the Federal income tax law so that charitable corporate gifts within the present 5% limit instead of being deductible on the tax return of the donor corporation, should to the extent of 50% of the gift, be a credit against the corporate tax. The deduction at present allowed in effect reduces the tax by 32% of the gift.

April 24, 1950
Brown University
California Institute of Technology (M)
Catholic University of America
Clark University
Columbia University
Cornell University
Duke University
Harvard University (M)
Indiana University
Johns Hopkins University
McGill University
Massachusetts Institute of Technology
New York University
Northwestern University
Ohio State University
Princeton University (M)
Stanford University
State University of Iowa
University of California
University of Chicago
University of Illinois
University of Kansas
University of Michigan
University of Minnesota
University of Missouri
University of Nebraska
University of North Carolina
University of Pennsylvania
University of Rochester
University of Texas
University of Toronto
University of Virginia
University of Washington
University of Wisconsin
Vanderbilt University
Washington University
Yale University

Providence, Rhode Island
Pasadena, California
Washington, D.C.
Worcester, Massachusetts
New York, N. Y.
Ithaca, New York
Durham, North Carolina
Cambridge, Massachusetts
Bloomington, Indiana
Baltimore, Maryland
Montreal, Canada
Cambridge, Massachusetts
New York, N. Y.
Evanston, Illinois
Columbus, Ohio
Princeton, New Jersey
Stanford University, California
Iowa City, Iowa
Berkely, California
Chicago, Illinois
Urbana, Illinois
Lawrence, Kansas
Ann Arbor, Michigan
Minneapolis, Minnesota
Columbia, Missouri
Lincoln, Nebraska
Chapel Hill, North Carolina
Philadelphia, Pennsylvania
Rochester, New York
Austin, Texas
Toronto, Canada
Charlottesville, Virginia
Seattle, Washington
Madison, Wisconsin
Nashville, Tennessee
St. Louis, Missouri
New Haven, Connecticut