

## University Endowments

University endowments and their tax-exempt status seems to be an ongoing discussion. After a short time out of the spot light due to the recent economic recession<sup>1</sup>, university endowments are back in the lime light...or the cross hairs of the media. With universities such as Harvard and Yale at the top of the list, the size of many university endowments is well within the billion dollar range.<sup>2</sup> Under §501(c)(3) of the Internal Revenue Code, the universities enjoy a tax exemption on not only the endowment itself, but also the investment revenue.<sup>3</sup>

The endowments fit into the §501(c)(3) exemption because they support and fund their respective universities' exempt purposes with the investment revenues generated. Among other things, the endowments provide financial aid to students, support research, and help cover operating costs of the universities. University endowments, unlike private foundations, have no minimum distribution requirements,<sup>4</sup> yet the universities they support retain the ability to acquire federal loans and grants to assist in tuition costs for students.<sup>5</sup>

The use and management of endowment funds are at the forefront of the argument for taxing university endowments. Universities seem to be unwilling to use the cash reserves from their endowments to balance out their operating budgets.<sup>6</sup> Instead, they have opted to make budget cuts to reduce their expenses in an effort to preserve their endowment value levels.<sup>7</sup> Additionally, the management practices of the endowment funds have been called into question. Universities are paying salaries in the realm of tens of millions of dollars to their investment managers.<sup>8</sup> As Harvard found out when it lost \$11B in less than a year, these higher salaries provide no guarantee for success or safety in the financial markets.<sup>9</sup> Another management issue is endowment spending. Universities with large endowments are fully capable of providing free tuition for their students if only they spent five percent or less of their endowment.<sup>10</sup> Harvard and

Yale are even capable of providing free tuition by spending less than one percent of their endowment.<sup>11</sup> This idea of free tuition is not the case, as tuition rates are rising above \$50,000 at some of these universities.<sup>12</sup>

Alternatives to the current system have been proposed in an effort to either tax or regulate university endowments in such a way that would make them more fairly distributive.<sup>13</sup> One mainstream idea that was being considered by Massachusetts is a two-and-a-half percent annual tax on endowments exceeding one billion dollars.<sup>14</sup> This could encourage universities to distribute a greater percentage back into the university to help fund tuition and operating costs. Another alternative would be to incorporate a capital gains tax, much like a hedge fund.<sup>15</sup> Lastly, the idea of creating a regulation forcing universities to distribute a fixed percentage of their endowments has been proposed.<sup>16</sup> Most investments earn around ten percent over the long-term, so this proposal would allow endowments to continue to grow, but also put much more money back into the university.

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<sup>1</sup> Gordon Smith, The Taxing and Spending of University Endowment, <http://www.theconglomerate.org/2009/10/the-taxing-and-spending-of-university-endowments.html>.

<sup>2</sup> Terence P. Jeffrey, Harvard Got \$5.6M in Federal Student Loans and Grants--Despite Its \$31.7B Tax-Exempt Endowment, <http://cnsnews.com/news/article/harvard-got-56m-federal-student-loans-and-grants-despite-its-317b-tax-exempt-endowment>.

<sup>3</sup> 26 U.S.C. § 501(c)(3) (2006).

<sup>4</sup> The Case for Making Harvard Pay Taxes, <http://www.thefiscaltimes.com/Articles/2011/10/07/The-Rich-University-The-Mother-of-all-Tax-Breaks.aspx#page2>.

<sup>5</sup> See *supra* note 2.

<sup>6</sup> See *supra* note 1.

<sup>7</sup> *Id.*

<sup>8</sup> Jim Manzi, Is Harvard Just A Tax-Free Hedge Fund?, <http://theamericanscene.com/2008/05/12/is-harvard-just-a-tax-free-hedge-fund>.

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<sup>9</sup> Christine McConville, Harvard Fund Loses \$11B Decline Less Than Predicted, [http://www.bostonherald.com/business/general/view/20090911harvard\\_fund\\_loses\\_11b\\_decline\\_less\\_than\\_predicted](http://www.bostonherald.com/business/general/view/20090911harvard_fund_loses_11b_decline_less_than_predicted).

<sup>10</sup> Lynne Munson, Endowment Reform: Why Universities Should Share Their Vast Wealth and in the Process Make Higher Education More Affordable, [http://www.centerforcollegeaffordability.org/uploads/Miller\\_Munson\\_corrected.pdf](http://www.centerforcollegeaffordability.org/uploads/Miller_Munson_corrected.pdf).

<sup>11</sup> *Id.*

<sup>12</sup> *See supra* note 2.

<sup>13</sup> *See supra* note 9.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*