The Impact of Proposed Endowment Tax Changes

Executive Summary

- Congress is currently discussing multiple endowment tax proposals.
- While most colleges today pay no federal tax as nonprofit institutions, the 2017 Tax Cuts and Jobs Act (TCJA) introduced a 1.4% excise tax on the wealthiest of endowments. Fifty-six institutions paid that tax in 2023.[i]
- The new proposals look to (1) increase the existing excise tax from 1.4% to 21%[ii] or above, and (2) expand the applicability of the tax to include a broader range of institutions by reducing the endowment assets per student criteria.
- While there are many opponents, certain groups believe some version of these proposals will get passed.
- The greatest impact on affected institutions would be the reduction of funds available to the institutions to support their mission, whether financial aid or general operating budget.
- Higher endowment taxes will also raise the required rate of return for endowments. TIFF is available to assist clients in navigating these challenges and understanding the potential implications for their portfolios.

The Impact of Proposed Endowment Tax Changes

The discussion surrounding the taxation of college endowments is intensifying as legislators evaluate potential amendments to the existing tax regulations. The most well-known proposed changes have centered around increasing the rate at which endowments are taxed and broadening the group of colleges and universities that are impacted. If enacted, these proposals could materially change the financial strategies of these institutions.

Understanding the Current Excise Tax

Historically, colleges and universities operated as tax-exempt nonprofits, with no taxes paid on donations or investment earnings. However, during the first Trump administration, the Tax

Cuts and Jobs Act (TCJA) of 2017 introduced an endowment tax. The existing tax is as follows:

- **Tax:** 1.4% excise tax on net investment income.
- **Criteria for inclusion:** (1) private institutions with (2) at least 500 tuition-paying students and (3) endowment assets exceeding $500,000 per full-time student.

The rationale behind the tax was to generate additional revenue and address concerns that educational institutions were not contributing enough to public finances. The tax aimed to encourage colleges and universities to use their endowment funds to reduce tuition costs and increase student aid.

The tax affects only the wealthiest of private colleges and universities. In 2023, 56 universities paid about $380 million in endowment tax, up from about $68 million in 2021 from 33 institutions[1]. The tax threshold for qualifying for taxation is not adjusted for inflation, resulting in an increasing number of schools becoming liable for the tax over time. As college and university endowments continue to grow, the associated tax revenue will grow as well.

Proposed Changes to the Endowment Tax Law

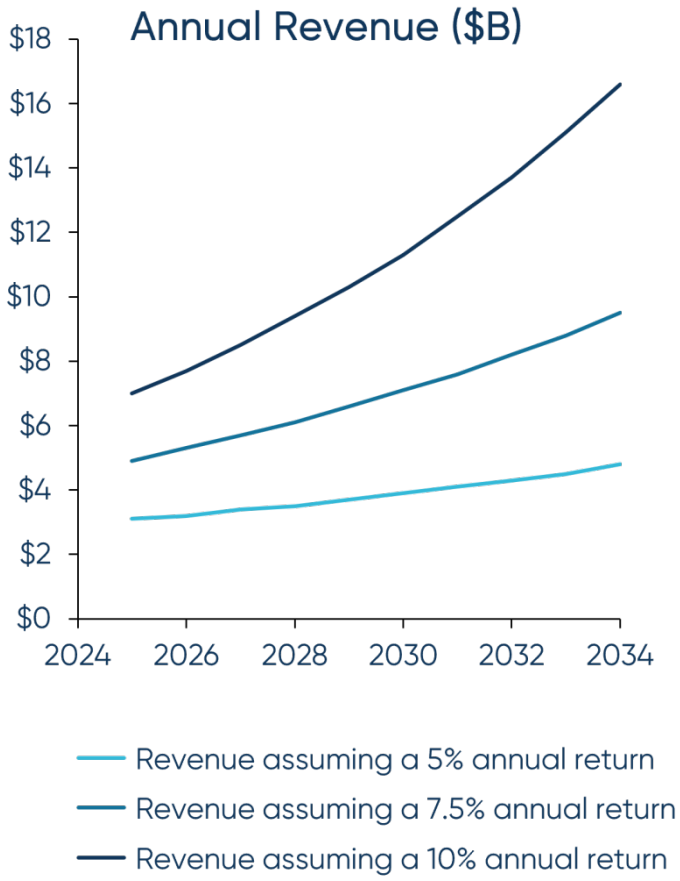
The Trump administration's tax proposals for 2025 focus on extending and potentially expanding some of the provisions of the TCJA of 2017, which are set to expire at the end of this calendar year. While the endowment excise tax is permanent, it has garnered attention due to its significant revenue-generating potential and the current federal budget deficit.

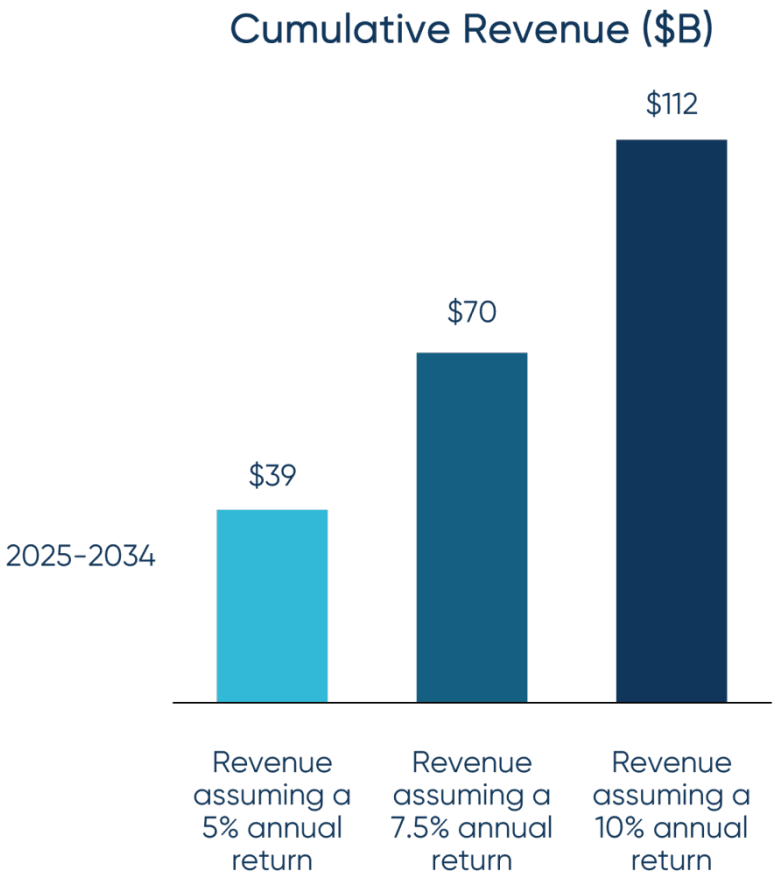
Proposed adjustments to the endowment tax focus on two potential changes:

- **Increasing the excise tax rate:** Proposals suggest raising the tax rate from 1.4% to 10%, 14%, 21% or potentially even higher.
- **Expand the number of colleges and universities subject to the tax:** Proposals range from no change to lowering the criteria to $200,000 of assets per student. Rep. Michael Lawler (R-NY-17)'s *Endowment Accountability Act* proposes the reduction to $200,000 of assets per student[iii] while Rep. Troy E. Nehls (R-TX-22)'s *Endowment Tax Fairness Act* does not include an expansion.

As with TCJA of 2017, the objective is to raise federal revenue further to reduce the national deficit.[iv] Taxfoundation.org estimates that increasing the endowment tax from 1.4% to 21%, with a 7.5% average annual endowment return, would generate about $69.8 billion in extra revenue over 10 years.

Taxing Endowments: Revenue Analysis of an Endowment Tax





Source: Taxfoundation.org

How Likely Is this Expanded Endowment Tax to Pass?

These proposals are still in the early stages, and there are many opponents. Certain groups believe changes are likely due to the administration's focus on fair resource distribution and raising federal revenue. The first Trump administration passed the first-ever endowment tax, albeit small, and the second Trump administration has struck an action-oriented tone. It remains to be seen what is approved, if anything, and in what form.

Potential Implications of the Proposed Tax Law Changes on Impacted Endowments

For those impacted, the proposed increase in the endowment tax would undoubtedly reduce the amount of endowment funds available to support the institution's mission. Colleges and universities are preparing for possible tax changes and trying to understand how these challenges might affect the higher education landscape more broadly.

School business offices are thinking about the impact higher taxes will have on:

- **College affordability:** Higher taxes could reduce funds for tuition assistance and scholarships, making college less affordable for some students.
- **Budget and spending:** Tuition alone doesn't cover education costs, so institutions rely on endowments and donors to fill the gap. Reduced support from the endowment could force cuts to student services, infrastructure, and other areas.
- **Research funding**: Increased taxes could lead universities to scale back research initiatives, affecting advancements in science, technology, and medicine.
- **Charitable giving:** Higher taxes might deter future donations, as donors may not want part of their gift to go toward taxes.

The long-term effects of taxing endowments are a topic of debate. However, the bottom line is that colleges and universities will need to generate returns to offset any tax burden. Given that most colleges and universities pursue an investment return of inflation plus spend (historically around 8% and not always easy to achieve), compensating for an increased tax burden will lead to changes in investment strategy.

Conclusion

Legislators are closely examining the nonprofit sector to generate funding for other projects and ensure that wealthy educational institutions contribute more to public finances. Forecasting the future of the tax landscape is difficult and as a result, colleges and universities are beginning to prepare for the unknown. Those responsible for overseeing the endowment are engaging in several activities to prepare:

- Maintaining communication with the college and university's tax and legal counsel to stay informed about developments in tax law.
- Forming advocacy consortiums to ensure their collective point of view is heard around the role and benefits of endowments.
- Discussing with the business office the implications of possible tax law changes on the college and university's budget and spending.
- Exploring tax-efficient investment strategies that could help mitigate a larger potential tax burden.

While the direction of tax reform is uncertain, TIFF is prepared to assist higher education institutions in meeting their financial needs. For more information, please contact info@tiff.org.

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[i] Endowments impacted under the current tax include Harvard University, Yale University, Princeton University, Stanford University, Massachusetts Institute of Technology (MIT), the University of Pennsylvania, Northwestern University, Washington University, Duke University, and Vanderbilt University per https://nehls.house.gov/media/press-releases/rep-troy-e-nehls-introduces-bill-hold-elite-university-endowments-accountable.

[ii] 21% is proposed in Rep. Troy Nehls (R-TX)'s *Endowment Tax Fairness Act*, which would match the federal corporate income tax rate. The House Ways & Means Committee's Chair Jason Smith (R-MO) outlined a 14% rate. Rep. Michael Lawler (R-NY)'s *Endowment Accountability Act* proposes 10%.

[iii] https://lawler.house.gov/news/documentsingle.aspx?DocumentID=3716

[iv] Rep. Troy E. Nehls (R-TX-22)'s *Endowment Tax Fairness Ac*t states its objectives as "The revenue derived from the amendment made by this section shall be deposited in the general fund of the Treasury and shall be used to reduce the national deficit, to the extent thereof, and thereafter to reduce the national debt."

Footnotes

1. Source: "University Endowment Tax Receipts Rise Again," *Nonprofit Issues*, accessed February 25, 2025, https://www.nonprofitissues.com/article/university-endowment-tax-receipts-rise-again.

TIFF Investment Management



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