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Matt Willie

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I. INTRODUCTION

Colleges and universities in the United States have enjoyed ballooning endowment growth in recent years, leading to colossal reserves of wealth at the most elite institutions. In September 2011, for example, Harvard University announced that its endowment was worth $32 billion after experiencing a 21% return on investments during the 2011 fiscal year.[1] Likewise, Yale's endowment grew to $19.4 billion on returns of 22% over the same period.[2] And while Harvard and Yale are easily the nation's richest schools, they have not been alone in their good fortune. At the end of the 2011 fiscal year, seventy-three additional higher-education institutions in the United States had endowments worth more than $1 billion.[3]

At the same time, the cost of a college degree has continued to spiral higher. From 2010 to 2011, tuition and fees rose by 4.5% at private, nonprofit colleges and more than 8% at public institutions.[4] These figures are part of a thirty-year trend of steady increases in the sticker price of higher education;[5] since 1986, tuition has grown by nearly

1. Gautam S. Kumar & Zoe A.Y. Weinberg, *Harvard Endowment Jumps 21.4 Percent*, HARV. CRIMSON (Sept. 22, 2011), http://www.thecrimson.com/article/2011/9/22/hmc-endowment-returns-2011.

2. Tom Conroy, *Investment Return of 21.9% Brings Yale Endowment Value to $19.4 Billion*, YALE NEWS, (Sept. 28, 2011), http://news.yale.edu/2011/09/28/investment-return-219-brings-yale-endowment-value-194-billion.

3. NAT'L ASS'N OF COLL. & UNIV. BUS. OFFICERS & COMMONFUND INSTITUTE, U.S. AND CANADIAN INSTITUTIONS LISTED BY FISCAL YEAR 2011 ENDOWMENT MARKET VALUE AND PERCENTAGE CHANGE IN ENDOWMENT MARKET VALUE FROM FY 2010 TO FY 2011 (2012) [hereinafter NACUBO 2011 STUDY], *available at* http://www.nacubo.org/Documents/research/2011_NCSE_Public_Tables_Endowment_Market_Values_Final_January_17_2012.pdf.
Despite such phenomenal wealth, nearly half of all educational endowments still sit slightly below pre-recession levels. *See University Endowments Beginning to Regain Recession Losses*, CHI. SUN-TIMES (Jan. 31, 2012), http://www.suntimes.com/news/education/10350888-418/university-endowments-beginning-to-regain-recession-losses.html.

4. SANDY BAUM & JENNIFER MA, COLL. BD. ADVOCACY & POLICY CTR., TRENDS IN COLLEGE PRICING 2011, 10 (2011), *available at* http://trends.collegeboard.org/sites/default/files/College_Pricing_2011.pdf.

5. *See id.* at 13 (showing tuition and fee increases at public and private colleges and universities since 1982).

500%, far outpacing inflation[6] and creating fears that college may soon be "out of reach for most Americans."[7]

These fears have prompted commentators to propose numerous endowment-related legislative reforms.[8] Most have focused on mandatory endowment distributions,[9] taxes on the endowment income of wealthy schools,[10] increased transparency from universities regarding endowment use and accumulation,[11] or changes to donor tax laws.[12] Despite widespread academic criticism of traditional justifications for endowment accumulation,[13] these proposals have largely been met with skepticism by scholars who fear, among other things, potential

6. *See* Timothy McMahon, *College Tuition & Fees vs. Overall Inflation (CPI-U) Cumulative Inflation Comparison*, INFLATIONDATA.COM (June 14, 2012), http://inflation data.com/inflation/im ages/charts/Education/Education_inflation_chart.htm.

7. Tamar Lewin, *College May Become Unaffordable for Most in U.S.*, N.Y. TIMES, Dec. 3, 2008, at A19, *available at* http://www.nytimes.com/2008/12/03/education/03college.html.

8. *See* Sarah E. Waldeck, *The Coming Showdown Over University Endowments: Enlisting the Donors*, 77 FORDHAM L. REV. 1795, 1799 (2009) ("[C]ritics [of endowment accumulation] have floated multiple proposals for congressional action."); Alexander M. Wolf, Note, *The Problems with Payouts: Assessing the Proposal for a Mandatory Distribution Requirement for University Endowments*, 48 HARV. J. ON LEGIS. 591, 591 (2011) ("[L]awmakers at the state and federal levels considered regulating or taxing university endowments.").

9. *See, e.g.*, Jonathan D. Glater, *House Passes Bill Aimed at College Costs*, N.Y. TIMES Feb. 8, 2008, http://www.nytimes.com/2008/02/08/education/08education.html (describing a proposal, eventually withdrawn from a 2008 education bill, that would have forced universities "to spend at least 5 percent of their endowment assets each year").

10. *See, e.g.*, Waldeck, *supra* note 8, at 1817 (discussing various iterations of this plan); Peter Schworm & Matt Viser, *Lawmakers Target $1B Endowments*, BOS. GLOBE May 8, 2008, http://www.boston.com/news/local/articles/2008/05/ 08/lawmakers_target_1b_endowments (describing a Massachusetts law that would have taxed colleges with endowments worth more than $1 billion).

11. *See, e.g.*, Press Release, Office of Senator Charles Grassley, Sen. Grassley Works to Build Confidence in Nonprofits with Greater Transparency (May 29, 2007) [hereinafter Grassley Press Release 1], *available at* http://grassley.senate.gov/news/Article.cfm?customel _dataPageID_1502=1 2581.

12. *See, e.g.*, Waldeck, *supra* note 8, at 1818–22.

13. Henry Hansmann, *Why Do Universities Have Endowments?*, 19 J. LEGAL STUD. 3, 39 (1990) ("It is not clear . . . that the sizes of existing endowments, and the ways in which they are managed, are well chosen to serve [the] goals [of higher education]."); Peter Conti-Brown, *Scarcity Amidst Wealth: The Law, Finance, and Culture of Elite University Endowments in Financial Crisis*, 63 STAN. L. REV. 699, 705 (2009) ("It is not obvious why universities maintain large capital reserves at all . . . ."); Walkdeck, *supra* note 8, at 1810 ("[U]pon close examination, the common justifications for mega-endowments are unpersuasive.").

unintended consequences.[14] Chief among these fears is the concern that endowment regulation would actually encourage tuition increases.[15]

A solution left unaddressed in the legal literature and largely ignored by policymakers, however, is to link an endowment tax to tuition rates. Under such a proposal, the government could tax a university's endowment income when the endowment grows during the same year that tuition at the school increases by more than inflation. Accordingly, as long as tuition increases do not outpace inflation, universities could accumulate endowment income tax-free.

This Comment examines this policy proposal in detail. Part II begins by discussing the rising costs of college tuition and the growing concern over educational access. It then offers a brief introduction to university endowments and discusses the most commonly recognized justification for their existence and growth: intergenerational equity. This justification and its outgrowths have been the subjects of significant academic criticism, and scholars have suggested new theories for endowment accumulation that cut against normative arguments for awarding universities tax-exempt status. Part III discusses the advantages and criticisms of the most commonly debated policy proposals related to university endowments. Unfortunately, all of these proposals suffer from the same defect: they are unlikely to significantly impact the affordability of higher education.

Thus, in Part IV, this Comment argues that tying an endowment tax directly to tuition increases represents a unique solution. Unlike other endowment-related measures, such a tax would discourage tuition hikes without encouraging wasteful spending. Perhaps more important, it would not necessarily discourage endowment growth or require cuts to current levels of funding for other important academic pursuits, such as research. This would leave room for universities to pursue traditional

14. *See* Mark J. Cowan, *Taxing and Regulating College and University Endowment Income: The Literature's Perspective*, 34 J.C. & U.L. 507, 551 (2008) ("[T]here is not a strong theoretical case for imposing a tax . . . on endowments."); Frances R. Hill, *University Endowments: A (Surprisingly) Elusive Concept*, 44 NEW ENG. L. REV. 581, 600 (2010) (arguing that distribution requirements will not increase the affordability of higher education or its operating costs); Waldeck, *supra* note 8, at 1813–18 (criticizing a mandatory spending proposal because it may affect a university's spending priorities "in ways that are contrary to the overarching goal of controlling tuition" and expressing concern that an endowment tax could prompt tuition increases); Wolf, *supra* note 8, at 606 ("[A] distribution requirement will not improve affordability across the higher education sector.").

15. *See* Waldeck, *supra* note 8, at 1817.

goals of intergenerational equity while still being closely tethered to their tax-exempt purposes.

II. THE CONTROVERSY OVER ENDOWMENTS

A. Rising Tuition and the Institutional-Wealth Gap

Researchers have tracked movements in tuition for approximately thirty years.[16] During that period, published college prices have consistently increased more rapidly than prices for other goods or services.[17] In fact, since 1981, the average total cost, in constant dollars, of tuition, fees, room, and board at undergraduate institutions in the United States has more than doubled.[18]

Unfortunately, the largest increases, particularly in recent years, have come at public schools, not private universities.[19] Statistics from the Department of Education show an almost 90% spike in inflation-adjusted

16. *See, e.g.*, BAUM & MA, *supra* note 4, at 8 (noting that the College Board has been collecting data on tuition for only a thirty-year period).

17. *Id.* An adequate explanation for this phenomenon would mostly likely require a lengthy, multi-factored analysis. *See, e.g.*, R. Paul Guerre, Note, *Financial Aid in Higher Education: What's Wrong, Who's Being Hurt, What's Being Done*, 17 J.C. & U.L. 483, 486–88 (1991) (listing twelve possible justifications for higher-education pricing practices). Such a discussion is thus outside the scope of this comment. It is worth noting, however, that there is a growing consensus among scholars that the federal government's guaranteed student-loan program is at least partially to blame for tuition increases. *See, e.g.*, ANYA KAMENETZ, DIY U: EDUPUNKS, EDUPRENEURS, AND THE COMING TRANSFORMATION OF HIGHER EDUCATION 63 (2010) ("The liftoff of college tuition into the stratosphere in the past thirty years . . . is concurrent with . . . the rise of student loans . . . . [T]he ability to finance tuition through loans . . . has made families less sensitive to tuition increases—a vicious cycle that leads from rising tuition to increased debt loads back to rising tuition."); Roger Roots, *The Student Loan Debt Crisis: A Lesson in Unintended Consequences*, 29 SW. U. L. REV. 501, 501 (2000) ("[T]he [federal student-loan] program has interfered with the educational marketplace by unnecessarily causing tuitions to increase."); Kyle L. Grant, Comment, *Student Loans in Bankruptcy and the "Undue Hardship" Exception: Who Should Foot the Bill?*, 2011 BYU L. REV. 819, 824 (2011) ("[A]s long as financing remains the primary revenue generator [at higher-education institutions], universities will continue to raise their tuition."). To the extent these scholars are correct, endowment accumulation could be less controversial in a world without federal student loans.

18. INST. OF EDUC. SCIENCES, NAT'L CTR. FOR EDUC. STATISTICS, DIGEST OF EDUCATION STATISTICS 2010, at 493 tbl.345 (2011), *available at* http://nces.ed.gov/programs/digest/d10/tables/dt10_345.asp.

19. *See* BAUM & MA, *supra* note 4, at 3 ("For the fifth consecutive year, the percentage increase in average tuition and fees at public four-year institutions was higher than the percentage increase at private nonprofit institutions."); *see also*, Editorial, *Reining in College Tuition*, N.Y. TIMES, Feb. 4, 2012, at A20, *available at* http://www.nytimes.com/2012/02/04/opinion/reining-in-college-tuition.html ("[T]he cost of four-year public college tuition has tripled since the 1980s . . . .").

tuition rates at public colleges and universities from 2000 to 2010.[20] Even relatively wealthy schools occasionally approve extreme tuition increases. In 2011, for example, California's two public university systems, which together enjoy endowment funds worth more than $7 billion,[21] raised tuition and fees by a combined 21% at four-year institutions and a staggering 37% at two-year colleges.[22]

Such instances are especially troubling because of the number of individuals and families affected.[23] Public colleges and universities provide education for nearly three-quarters of the country's students.[24] Traditionally, a core mission of these schools has been to "promote the well-being of communities and states,"[25] but tuition increases like those in California can be particularly burdensome for in-state students who may be reluctant to pay the much higher nonresident tuition rates of other states' public schools.[26]

Moreover, students can easily feel "shut out by the stratospheric cost of private colleges."[27] While tuition increases at private institutions in recent years have been more moderate than those at public schools, the cost of a private education has long been prohibitively expensive for many families. Undergraduate tuition and fees at Harvard, for example,

20. INST. OF EDUC. SCIENCES, *supra* note 18 (showing a constant-dollar increase in tuition and fees from $2,506 in 1999–2000 to $4,751 in 2009–10 at public institutions).

21. The University of California's (UC) endowment grew by 16.6% to $6.34 billion in 2011, making it the thirteenth largest in the country. NACUBO 2011 STUDY, *supra* note 3. The California State University (CSU) system's endowment surpassed $1 billion in 2011 after enjoying investment gains of more than 20%. THE CAL. STATE UNIV., 2010/11 PHILANTHROPIC ANNUAL REPORT, http://www.calstate.edu/universityadvancement/reports/1011philanthropicsupport/endowment_market.shtml (last visited Feb. 21, 2012).

22. BAUM & MA, *supra* note 4, at 3. The universities blamed the increases on state funding cuts, while policymakers criticized the institutions for their questionable financial decisions. *See infra* notes 211–13 and accompanying text.

23. The CSU system, for example, serves nearly 427,000 students, while the UC system enrolls an additional 220,000. *See* THE CAL. STATE UNIV., http://www.calstate.edu/ (last visited Feb. 21, 2012); UNIV. OF CAL., *It Starts Here: UC at the Frontier*, http://www.universityofcalifornia.edu/aboutuc/welcome.html (last visited Feb. 21, 2012).

24. Editorial, *supra* note 19.

25. Sam Dillon, *At Public Universities, Warnings of Privatization*, N.Y. TIMES Oct. 16, 2005, http://www.nytimes.com/2005/10/16/education/16college.html.

26. *See* Jonathan D. Glater, *Colleges Reduce Out-of-State Tuition to Lure Students*, N.Y. TIMES Mar. 8, 2008, http://www.nytimes.com/2008/03/08/education/08states.html ("Even at universities that are cutting their prices for out-of-state students, which can be triple tuition for state residents, nonresidents still generally pay 50 percent more.").

27. Paul Fain, *At Public Universities: Less for More*, N.Y. TIMES Oct. 26, 2009, http://www.nytimes.com/2009/11/01/education/edlife/01public-t.html.

totaled $39,849 in 2011.[28] Yale's tuition was even higher, at $40,500.[29] And Columbia University, which has the nation's eighth largest endowment, at $7.79 billion,[30] charges its undergraduates $45,290 per year.[31]

These figures give rise to related concerns about "a growing institutional wealth gap" in higher education.[32] While Harvard, Yale, Columbia, and a handful of other schools have multibillion-dollar endowments, as of 2008, more than 4,100 of the nation's 4,500 colleges and universities had endowments worth less than $100 million.[33] While even these smaller amounts represent substantial capital, commentators complain that the wealth disparity creates awkward tensions as poorer colleges attempt to compete with elite schools.[34] As a 2008 *New York Times* article described, less wealthy institutions "are going into fund-raising overdrive," struggling to retain faculty and, in some cases, charging exorbitant tuition and then "scrambling to explain why their financial aid cannot match the most prosperous of the Ivy League."[35]

The problem, of course, is that less wealthy schools can never make up enough ground to compete with the Harvards and Yales of the academic world—at least not under the current system.[36] Students at elite private universities are arguably more willing than their peers at less wealthy institutions to tolerate inflated tuition rates because of the relative levels of prestige that accompany their degrees. As a result, schools like Harvard and Yale, already blessed with extraordinary endowments, continue to generate massive revenue with which to fund important research programs, attract top faculty, improve physical facilities, subsidize athletic programs, and recruit the most promising

28. U.S. NEWS & WORLD REPORT, *National University Rankings*, http://colleges.usnews.rankingsandreviews.com/best-colleges/rankings/national-universities (last visited Nov. 2, 2012).

29. *Id.*

30. NACUBO 2011 STUDY, *supra* note 3.

31. U.S. NEWS & WORLD REPORT, *supra* note 28.

32. Waldeck, *supra* note 8, at 1795.

33. Karen W. Arenson, *Endowments Widen a Higher Education Gap*, N.Y. TIMES Feb. 4, 2008, http://www.nytimes.com/2008/02/04/education/04endowment.html.

34. *Id.*

35. *Id.*

36. *See* Waldeck, *supra* note 8, at 1803–04 ("[T]he gap in instructional spending between rich and poor institutions continues to grow. In the past ten years, average instructional spending at institutions in the top quartile of wealth has grown by 37%, while instructional spending by those schools in the bottom quartile has grown by only 6%. At the same time, the amount of debt carried by poorer institutions continues to increase." (footnote omitted)).

students.[37] As their graduates go on to secure lucrative employment and eventually become wealthy university donors in their own right, the cycle perpetuates.[38]

Concerns about the costs of a college degree and the growing institutional wealth gap have raised questions about whether universities are managing their endowments appropriately. To answer such questions, it is important to understand what endowments are and why universities seek to grow them.

B. Justifications for Endowment Growth and Criticisms of Tax-Exempt Status

1. What are endowments?

In a strictly legal sense, the term "endowment" refers to money that a university may not spend. That is, "[t]rue endowment funds are" given to a college "on the condition that the principal is to be preserved . . . ."[39] While income from endowment investments may be used to fund university activities, trust law requires that institutions abide by donor restrictions.[40] Thus, as Peter Conti-Brown explains, "[i]f one gives money to Stanford University exclusively for the humanitarian

37. *See* Arenson, *supra* note 33 ("The wealthiest colleges can tap their endowments to give substantial financial aid to families earning $180,000 or more. They can lure star professors with high salaries and hard-to-get apartments. They are starting sophisticated new research laboratories, expanding their campuses and putting up architecturally notable buildings."); *see also* Waldeck, *supra* note 8, at 1804 ("Rich colleges are able to spend ample funds on classroom instruction and still build campus amenities 'like fitness centers and wireless-Internet hot spots.' These amenities raise student expectations . . . . Less wealthy institutions are thus pressured to add similar amenities by diverting funds from other purposes, including those more directly related to education." (quoting Jeffrey Selingo & Jeffrey Brainard, *The Rich-Poor Gap Widens for Colleges and Students*, CHRON. HIGHER EDUC., Apr. 7, 2006, at A1)).

38. As an example, Arenson's article tells of Allan T. Demaree, a former *Fortune* magazine editor, who "gladly makes donations to Princeton University, his alma mater, even though he knows it has become one of the wealthiest educational institutions in the world." Arenson, *supra* note 33.

39. J. PETER WILLIAMSON, FUNDS FOR THE FUTURE: COLLEGE ENDOWMENT MANAGEMENT FOR THE 1900'S, at 1-12 (1993), *available at* http://www.commonfund.org/InvestorResources/Publications/Books/Funds%20for%20the%20future.pdf.

40. Conti-Brown, *supra* note 13, at 722. A university's total endowment is usually made up of "thousands of smaller endowment funds" designated by donors for specific purposes, such as support for a research center or library. Wolf, *supra* note 8, at 593. *See also* Cowan, *supra* note 14, at 522 ("Colleges and universities . . . claim an endowment represents thousands of separate accounts with specific, designated purposes, such as a named or endowed professorship, a scholarship, a center, etc.").

elimination of the university's squirrels . . . , and Stanford accepts the gift, then the university may not use that gift for any other purpose."[41]

Scholars and policymakers discuss "endowments" in their more colloquial sense, however, referring to an institution's "total reserve funds," which include both restricted and unrestricted sums.[42] In fact, because elite universities tend to accumulate endowment income and build endowments with unrestricted gifts, studies suggest that nearly half of all funds considered to be part of the average private school's "endowment" are unrestricted.[43] Moreover, the Uniform Prudent Management of Institutional Funds Act, adopted in all but two states,[44] has relaxed spending rules for universities, allowing them to dip into "underwater" endowments (i.e., endowments worth less than their original gift values as a result of investment losses), subject to certain standards.[45] Thus, in most cases, well-endowed colleges and universities are not meaningfully restricted in their endowment spending.[46] Considering the growing concern over tuition increases, this raises questions regarding universities' tendency to accumulate, rather than spend, endowment income.

2. Why do universities seek to grow endowments?

For decades scholars have struggled to explain why universities strive to increase the size of their endowments—or for that matter, "why

41. Conti-Brown, *supra* note 13, at 722.

42. Cowan, *supra* note 14 at 522; *see also* WILLIAMSON, *supra* note 39, at 1-13 ("The terms 'restricted' and 'unrestricted' are occasionally incorrectly used as synonyms for 'true' and 'quasi' endowment. 'Restricted' properly refers not to whether principal may legally be invaded but to the use to which spending may be applied, regardless of whether that spending includes income only or both income and principal.").

43. *See* Conti-Brown, *supra* note 13, at 723 ("The largest endowments have only between 50% and 60% of their funds restricted in any way."); Waldeck, *supra* note 8, at 1809 ("[T]he NACUBO study suggests that 45% . . . of the endowment funds at private institutions are unrestricted.").

44. UNIF. LAW COMM'N, LEGISLATIVE FACT SHEET — PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT (2006), *available at* http://uniformlaws.org/LegislativeFactSheet.aspx?title=Prudent%20Management%20of%20Institutional%20Funds%20Act.

45. Conti-Brown, *supra* note 13, at 719–20.

46. *See id.* at 703 ("[T]he law does not meaningfully restrict elite universities in endowment spending . . . ."). In fact, scholars generally agree that universities could find ways to free up more endowment income if they wanted. As Professor Waldeck explains, "restrictions are partially of the university's own making." She points out that colleges and universities "exert considerable influence over whether gifts are restricted or unrestricted, and, if restricted, the precise terms of the restriction." Waldeck, *supra* note 8, at 1809.

universities maintain large capital reserves at all."[47] Yale economist and law professor Henry Hansmann surveyed the issue in 1990, offering eleven possible explanations.[48] The theory that has garnered the most support among scholars is the notion of intergenerational equity.[49] In fact, most of Hansmann's other explanations are closely related to this theory.[50]

a. Intergenerational equity. Intergenerational equity "captures the concept that our contemporary society has a relationship with both past and future generations and raises the question of how these relationships should influence our decision making today."[51] Scholars often discuss intergenerational equity as it relates to property law or natural resources,[52] but economists have found its principles particularly appealing in the context of university endowments. As James Tobin explained:

> The trustees of an endowed institution are the guardians of the future against the claims of the present. Their task is to preserve equity among generations. The trustees of an endowed university like [Yale] assume the institution to be immortal. They want to know, therefore, the rate of consumption from endowment which can be sustained indefinitely. Sustainable consumption is their conception of permanent endowment income. . . . Consuming endowment income so defined means in

47. Conti-Brown, *supra* note 13, at 705.

48. Hansmann, *supra* note 13.

49. *See* Conti-Brown, *supra* note 13, at 706 ("Of the theories that Hansmann surveyed to explain the existence of university endowments, the idea of intergenerational equity has received the most attention from commentators.").

50. The other theories include the needs to smooth out "lumpy funding"; realize future tax benefits; maintain liquidity against short-term financial reversals; provide for long-term security; insulate the university from outside demands; ensure that certain values are passed to future generations; appeal to donors' preferences; serve the personal interests of university faculty and administrators; cater to the peculiar perspective of university trustees; and conform to custom or habit. Hansmann, *supra* note 13, at 19–39. Hansmann separates these theories into two categories. The first seven (including intergenerational equity) "all involve an appeal to the long-run best interests of society and, particularly, of students." *Id.* at 32. Thus, these theories can appropriately be considered outgrowths, or at least relatives, of the notion of intergenerational equity.

51. Keith Aoki, *Food Forethought: Intergenerational Equity and Global Food Supply—Past, Present, and Future*, 2011 WIS. L. REV. 399, 403 (2011).

52. *See, e.g.*, Edith Brown Weiss, *Intergenerational Equity: Toward an International Legal Framework*, *in* GLOBAL ACCORD: ENVIRONMENTAL CHALLENGES AND INTERNATIONAL RESPONSES 333 (Nazli Choucri ed., 1993); Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347 (1967).

> principle that the existing endowment can continue to support the same set of activities that it is now supporting.[53]

In the nearly forty years that have passed since Tobin made these statements, colleges and universities have continued to point to intergenerational equity as the primary justification for building endowments.[54] Most scholars who have examined the theory, however, have agreed that it "provide[s] very doubtful support for current endowment policies."[55]

b. Criticisms of intergenerational equity. Perhaps the most persuasive criticism of intergenerational equity is that it does not explain the actual behavior of educational institutions. Hansmann touched on this point, using Yale as an example. He noted that in the early half of the twentieth century, the school enjoyed significant increases in its endowment with almost no periods of dissaving.[56] Yet "Yale did not withdraw substantial funds from its endowment to help it through the financial crisis of the 1970s."[57]

Recent years have seen universities repeat this pattern. Despite enormous endowment growth from 2000 to 2007, wealthy schools made deep cuts in their operating budgets during the financial crisis of 2008, apparently in an attempt to preserve endowment corpus.[58] As Conti-Brown has described, the five private universities with the largest endowments—Harvard, Yale, Stanford, Princeton, and MIT—each cut their budgets by up to 15% during the recession.[59] Despite sitting "atop

53. James Tobin, *What is Permanent Endowment Income?*, 64 AM. ECON. REV. 427, 427 (1974).

54. *See* Conti-Brown, *supra* note 13, at 707 (discussing statements by colleges and universities to that effect).

55. Hansmann, *supra* note 13, at 14; s*ee also* Evelyn Brody, *Charitable Endowments and the Democratization of Dynasty*, 39 ARIZ. L. REV. 873, 935 (1997) ("I agree with all of Professor Hansmann's points, and the other intergenerational equity arguments against charitable endowments."); Waldeck, *supra* note 8, at 1807 ("On the current state of the economic evidence, endowment spending policies do not support intergenerational equity.").

56. Hansmann, *supra* note 13, at 24.

57. *Id.* Of course, Yale could not have withdrawn restricted funds, s*ee supra* note 39 and accompanying text, but there is strong evidence suggesting that a substantial portion of the school's endowment would have been unrestricted at this time. Despite the recession of the late 1970s and early 1980s, one study found that as of 1985, 38% of endowments worth more than $100 million were made up of unrestricted amounts. Hansmann, *supra* note 13, at 8.

58. *See* Conti-Brown, *supra* note 13, at 703 ("[U]niversities—including the wealthiest in the country—have made significant cuts to almost every area of their budgets.").

59. *Id.* at 702.

multibillion dollar endowments," they "laid off hundreds of employees, froze[] salaries, halted or delayed construction projects, issued billions of dollars in debt, canceled or downgraded varsity sports teams, and closed libraries, among many other responses."[60] While these cuts may have been wise financial decisions, Conti-Brown points out that they are inconsistent with the notion of intergenerational equity: "Students yesterday were supposed to have benefits withheld in order to ensure that students today received at least the same benefits. Under the present practice, however, students yesterday received benefits that students today no longer receive, making the promise of intergenerational equity hollow."[61]

A related criticism is that schools tend to invoke intergenerational equity as a justification for creating spending policies that prioritize endowment growth over other important educational interests. Preserving the endowment corpus, for example, is an overarching goal at many elite universities.[62] Even in years with strong investment returns, this can conflict with a school's ability to fund research or keep tuition costs down, especially if inflation rates also increase. An example from Professor Evelyn Brody illustrates the complication: "If the Princeton [endowment investment] plan produced a 9% 'total return' . . . at a time of 5% inflation, then 4% (applied to a moving average) remains for spending."[63] The problem is that if 4% is insufficient to cover the university's operating budget, Princeton, in the name of intergenerational equity, may decide to make up the difference by cutting programs or increasing tuition. Either choice seems like an odd result given that the university's wealth actually grew during the year and may have grown by much larger amounts in previous years. Of course, schools can argue that if inflation constantly outpaces real endowment gains, endowment income will "finance an ever-decreasing fraction of the cost of

60. *Id.* at 702–03.

61. *Id.* at 708.

62. *See id.* at 737 ("The idea that an endowment must remain sacred to the university . . . has a long history . . . ."); Waldeck, *supra* note 8, at 1811 ("The endowment . . . has become the primary yardstick by which boards of trustees judge not just themselves, but also their top administrators."); Brody, *supra* note 55, at 932 (discussing claims by university trustees that they are obligated to protect "the real value of the endowment.").

63. Brody, *supra* note 55, at 932; *see also* Tobin, *supra* note 53, at 429 ("[U]nder idealized conditions the university can consume the noninflationary fraction of the earnings of the businesses whose securities it holds. The remainder . . . must be plowed back to enlarge the endowment enough to keep up with inflation.").

education."[64] But this would be true only if university investments consistently failed to meet expectations and new gifts from donors were unable to make up the difference—both of which seem highly unlikely given the past performance of university endowments.[65]

Intergenerational equity is premised on the assumption that universities will exist forever.[66] This has attracted further criticism from scholars who believe this assumption encourages institutions to focus too little on the needs of the current generation. As economist Robert Eisner lamented, spending policies like the Princeton plan outlined above "reinforce and perpetuate the university practice of using endowments to build forever for the future. Jam tomorrow, but never jam today!"[67] Moreover, he argues, the idea that any school will last forever is simply unrealistic:

> Why should we act as if a university or any other institution is permanent? We know that nothing is permanent. . . . We know that needs change and we can anticipate that the needs for endowment income can change. We know that populations move and that particular universities may be in less demand in the future (while others may or may not be in greater demand). Indeed, almost nowhere in human behavior or in economic activity do we show a zero rate of time preference. We are always giving more weight to the present than to the future.[68]

Despite these criticisms, "endowment policy continues to seek capital preservation, while spending only a portion of growth."[69] These inconsistencies have led scholars to propose new theories to account for university behavior.

c. Emerging theories. In 1990, Hansmann suggested that endowment accumulation might be at least partially a product of the business-minded

64. Hansmann, *supra* note 13, at 17.

65. Despite various periods of economic decline, the "total inflation-adjusted endowment assets held by U.S. colleges and universities grew from just over $100 billion in 1989 to about . . . $418 billion in 2008 . . . ." U.S. GOV'T. ACCOUNTABILITY OFFICE, GAO-10-393, POSTSECONDARY EDUCATION: COLLEGE AND UNIVERSITY ENDOWMENTS HAVE SHOWN LONG-TERM GROWTH, WHILE SIZE, RESTRICTIONS, AND DISTRIBUTIONS VARY 9 (2010), *available at* http://www.gao.gov/assets/310/301008.pdf.

66. *See* Tobin, *supra* note 53, at 427 ("The trustees of an endowed university . . . assume the institution to be immortal.").

67. Robert Eisner, *Endowment Income: Discussion*, 64 AM. ECON. REV. 438, 439 (1974).

68. *Id.* at 440.

69. Brody, *supra* note 55, at 933.

tendencies of university trustees.[70] This explanation has garnered much recent support among academics.[71] Conti-Brown points out, for example, that "because trustees come from a world where money is the primary benchmark of success," they may consider endowment preservation to be their top priority.[72] Moreover, since trustees generally have little experience in the academic world, they "are often in a poor position to exercise meaningful oversight over the actual operations of the institution."[73]

This helps explain a second emerging theory for endowment growth—that university presidents increasingly define success in terms of their schools' wealth. Professor Sarah Waldeck has pointed out that university presidents are often "viewed as the nonprofit equivalents of chief executive officers, with compensation packages that reflect this corporate mindset."[74] She notes that in 2006, eighty-one presidents of private universities made at least $500,000—including twelve who received more than $1 million—and the largest public institutions paid their presidents comparable amounts.[75] Such salaries would have been "inconceivable just twenty years ago."[76]

These changes reflect academia's growing connection to the corporate world. In some cases, universities have shown a preference for hiring former business executives, rather than professors, to serve as presidents,[77] perhaps as a result of higher education's emphasis on fundraising.[78] In fact, college rankings, like those published by U.S. News and World Report, are often based in part on institutional wealth.[79]

70. Hansmann, *supra* note 13, at 37.

71. *See, e.g.*, Conti-Brown, *supra* note 13, at 738 ("The incentives and backgrounds of university administrators—ultimately those who make the decisions about endowment spending—may have much to do with a hypothesized view that the endowment must be preserved at all costs."); Waldeck, *supra* note 8, at 1810–11 (citing Hansmann, *supra* note 13, at 37) ("Just as outside observers use the endowment as a proxy for institutional success, boards of trustees are inclined to use the size of the endowment as a measure of their success in managing the university.").

72. Conti-Brown, *supra* note 13, at 738.

73. Hansmann, *supra* note 13, at 37.

74. Waldeck, *supra* note 8, at 1811.

75. *Id.*

76. *Id.* (internal quotation marks omitted).

77. *Id.*

78. *See* Conti-Brown, *supra* note 13, at 738–39 ("It has long been noted that the role of the university president is largely one of increasing the financial clout of the institution, usually by fundraising.").

79. *See* Waldeck, *supra* note 8, at 1810 ("The factors that are typically relevant when evaluating a college . . . have values that are at best subjective. In contrast, the value of an

This helps explain why "[a] university president who oversees a decline in the endowment will not . . . be considered a successful president."[80] Conti-Brown hypothesizes that "an intentional spending down of the endowment could cast a pall of failure on the president that could last for years. . . . This could explain the heavy bias toward resolving budgetary crises with budgetary disruption rather than with endowment disruption."[81]

A third emerging theory simply speculates that universities seek to grow endowments out of habit. As Professor Waldeck explains, endowment accumulation may have been a priority for so long that administrators simply "have not paused to consider whether it is still rational . . . ."[82] It might seem far-fetched to believe that "institutions . . . at the epicenter of American intellectual life" would ignore a question so important to the long-term interests of students and society.[83] But as Professor Waldeck points out, "when so much emphasis has been placed on the endowment, and for so long, at some point the endowment begins to become the university . . . [and] criticism[s] of endowment spending policies are perceived as striking at the very heart of the institution."[84] Endowment building out of "habit," then, is meant to suggest not that universities have purposely chosen to ignore the question of whether increasing their wealth serves society's best interests, but rather that the issue has become distorted by tradition. As Professor Waldeck observes, "a retreat from existing spending policies may seem tantamount to a confession of professional misjudgment. This provides all the more reason for mega-endowment institutions to hunker down and defend spending (or not spending) as usual."[85]

Much of the controversy surrounding endowment building depends on which set of theories proffers the best explanation for universities' financial behavior. Under the intergenerational equity model, current students must sacrifice only that portion of endowment income that is necessary to offer equal educational access and services to successive generations—a relatively uncontroversial notion. The emerging theories

endowment is a concrete measure of a university's success."); Conti-Brown, *supra* note 13, at 740 ("The absolute size of an endowment provides a clear criterion for objective ranking.").

80. Conti-Brown, *supra* note 13, at 739.

81. *Id.*

82. Waldeck, *supra* note 8, at 1810.

83. *Id.*

84. *Id.* at 1812.

85. *Id.*

outlined above, however, suggest far less socially beneficial motivations for endowment accumulation. Accordingly, they call into question the tax-exempt status of higher-education institutions.

3. Criticisms of tax-exempt status

Section 501(c)(3) of the Internal Revenue Code exempts from federal taxation any entity "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or *educational* purposes."[86] Because universities are engaged in "educational" pursuits, policymakers assume their funds—whether spent now or in the future—will be used to further the institutions' tax-exempt purposes. As a result, until relatively recently, observers have not seriously questioned higher education's favorable tax treatment, even when they have questioned the motives behind endowment accumulation.[87]

Section 501(c)(3) tax-exempt status may be inappropriate, however, if intergenerational equity and related theories for endowment growth do not adequately explain university behavior. As Hansmann pointed out, these traditional theories "involve an appeal to the long-run best interests of society and, particularly, of students."[88] Thus, they are consistent with the requirement in Section 501(c)(3) that universities be engaged in educational pursuits. The emerging theories outlined above, on the other hand, "involve no such social welfare argument."[89] Instead, they fall into a second category of theories that "suggest[s] that endowments may be at least in part a consequence of self-interested or short-sighted action by the individuals who support or manage universities."[90] In other words, these theories view endowment building as the pursuit of profit essentially for profit's sake, rather than to further educational pursuits.[91] To the extent that these emerging theories accurately explain endowment

86. 26 U.S.C. § 501(c)(3) (2012) (emphasis added).

87. *See, e.g.*, Hansmann, *supra* note 13, at 40 ("[I]t would be premature to propose changes in the law governing endowment accumulation and, in particular, to propose measures to limit the discretion of universities to accumulate large endowments.").

88. *Id.* at 32.

89. *Id.* at 33.

90. *Id.*

91. *See* Conti-Brown, *supra* note 13, at 741 ("[T]he value of the endowment, to the extent that it burnishes the university's reputation, becomes not simply a means of accomplishing other, more traditional university missions, but an end in and of itself.").

accumulation, they cut against normative arguments for awarding higher-education institutions full tax-exempt status.[92]

a. Nonprofit vs. for-profit. Debates about which set of theories best explains endowment building are difficult to resolve, largely because there is conflicting evidence on whether nonprofit higher-education institutions have actually crossed a for-profit line. On one hand, scholars in recent years have lamented the tendency among endowed universities to stray from their educational missions in pursuit of revenue generation.[93] Sheila Slaughter and Gary Rhoades, for example, have coined the phrase "academic capitalism" to describe how "[p]ublic and nonprofit institutions increasingly engage in market and market-like activities."[94] As the country's economy has become more information-oriented, they argue, colleges and universities have begun prioritizing revenue generation above other values.[95] As examples, they cite the growing emphasis on patent-producing—as opposed to publication-producing—scientific research; the increasing number of courses that can be taught by graduate assistants or adjuncts; the preference for expanding distance learning and other forms of educational access for employed business people rather than the socioeconomically disadvantaged; and the increased focus on generating profits from copyrightable educational materials.[96]

These practices illustrate what many see as a blurring of the nonprofit/for-profit line in higher education. Elite schools, once considered havens of "ethereal excellence, wisdom, and morality," are "steadily metamorphosing into lucrative enterprises."[97] Former Harvard

92. *See* Waldeck, *supra* note 8, at 1812 ("[W]hen the university's proffered justifications for its spending policies are unconvincing, and when other plausible explanations do not warrant deference, Congress needs to rethink its tax treatment of university endowments."). The purpose of this Comment is not to resolve this theoretical debate. In fact, a combination of theories—some consistent with tax-exempt status and some devoid of social-welfare arguments—might better explain endowment growth than any single theory could alone. Rather, the point here is to highlight what research is increasingly showing: that traditional justifications for endowment growth do not fully account for university behavior.

93. *See id.* at 1805 (discussing the concept of "mission drift").

94. SHEILA SLAUGHTER & GARY RHOADES, ACADEMIC CAPITALISM AND THE NEW ECONOMY: MARKETS, STATE, AND HIGHER EDUCATION 4 (2004); *see also* Gary Rhoades & Sheila Slaughter, *Academic Capitalism in the New Economy: Challenges and Choices*, 1 AM. ACAD. 37, 37 (2004), *available at* http://www.aft.org/pdfs/highered/academic/june04/Rhoades.qxp.pdf.

95. Rhoades & Slaughter, *supra* note 94, at 38.

96. *Id.* at 39–45.

97. Oksana Koltko, Comment, *Chasing Profits—Disregarding Values: Legal Persona of*

University president Derek Bok has written extensively on this "commercialization" of higher education. He explains:

> Universities learned that they could sell the right to use their scientific discoveries to industry and find corporations willing to pay a tidy sum to sponsor courses delivered by Internet or cable television. Apparel firms offered money to have colleges place the corporate logo on their athletic uniforms or, conversely, to put the university's name on caps and sweatshirts sold to the public. Faculty members began to bear such titles as Yahoo Professor of Computer Science or K-Mart Professor of Marketing. The University of Tennessee, in a coup of sorts, reportedly sold its school color to a paint company hoping to find customers wishing to share in the magic of the college's football team by daubing their homes with "Tennessee Orange." One enterprising university even succeeded in finding advertisers willing to pay for the right to place their signs above the urinals in its men's rooms.[98]

Although such commercialization efforts are not new to higher education, "the size of the accumulated funds . . . , the techniques employed to attract and multiply these funds, the types of . . . institutions engrossed in the corporatization processes, and the level of concentration on . . . profit-generation are new."[99]

On the other hand, revenue generated from commercialization can provide significant educational benefits to students and society; thus, commercialization does not necessarily require a change in the way universities are treated under the tax code (although scholars have argued that in certain cases it should[100]). In fact, Congress has traditionally refrained from placing conditions on nonprofit institutions' tax-exempt status unless "there was reason to doubt that [the institutions were] using their funds for exempt activities."[101] Professor Frances R. Hill argues that no such doubts exist with colleges and universities, since even undistributed endowment funds can be considered "money in use," or money contributing to universities' educational pursuits.[102] Because an

Elite Schools and Their Destructive Tax-Exempt Status, 42 J. MARSHALL L. REV. 1073, 1074 (2009).

98. DEREK BOK, UNIVERSITIES IN THE MARKETPLACE: THE COMMERCIALIZATION OF HIGHER EDUCATION 2 (2003).

99. Koltko, *supra* note 97, at 1075.

100. *See, e.g.*, Peter D. Blumberg, Comment, *From "Publish or Perish" to "Profit or Perish": Revenues from University Technology Transfer and the § 501(c)(3) Tax Exemption*, 145 U. PA. L. REV. 89, 139–42 (1996) (arguing that the unrelated business income tax should be expanded to cover certain types of technology transfers from universities to the private sector).

101. Hill, *supra* note 14, at 581.

102. *Id.* at 585.

endowment produces income for current university operations and enhances a school's ability to secure financing and make long-term budgeting plans, she contends that the endowment furthers the goals of higher education even when income from it is saved rather than distributed.[103]

b. The fine line. Unlike much of the legal literature on this subject, this Comment does not attempt to disregard either side of the tax debate. Rather, the purpose here is to stress that any endowment-related policy worthy of consideration should take account of the competing motivations underlying university revenue-generation practices. Those motivations are meaningful for tax purposes not because endowment building cannot further educational goals (in fact, the opposite is often true), but rather because endowment building is consistent with the 501(c)(3) exemption only if it is done with an eye toward producing a higher-quality and less-expensive education for students. Ideally, regulation in this area will walk a fine line, discouraging endowment accumulation when it decreases educational access or violates principles of intergenerational equity, but endorsing endowment-building activities that are consistent with tax-exempt educational purposes. As the following section describes, the most commonly proposed endowment policies have not lived up to this ideal.

III. ENDOWMENT POLICY PROPOSALS AND THEIR CRITICISMS

The debate over university endowments has led to four proposals for potential legislation: (A) impose a minimum spending requirement on universities; (B) impose a tax on the investment income of well-endowed schools; (C) require more transparency from universities regarding their endowment spending and accumulation practices; and (D) modify donor-tax laws to indirectly influence university behavior. Each of these proposals is designed to encourage schools to spend more of their endowments, but each suffers from several serious flaws.

A. Mandatory Distribution Requirement

The proposal that has garnered the most attention among policymakers—and by far the most academic criticism—is to impose a distribution requirement, or "mandatory payout," on educational

103. *Id.*

endowments.[104] Under this measure, universities would be forced to annually spend a certain percentage of their assets.[105] Most iterations of the proposal have been modeled on the five-percent spending rule applicable to nonprofit foundations,[106] although some have argued the percentage should be even higher.[107]

While a five-percent rule would force most universities to spend more of their endowment than they currently do,[108] because the proposal does not necessarily encourage the right kind of spending, scholars fear it could do more damage than good.[109] As one economist opined, if elite schools spend endowment primarily to attract more prestigious faculty and build expensive facilities, a spending rule "would have the unintended consequence[] of accelerating the academic arms race."[110] That is, as wealthy universities improve existing amenities, poorer schools may feel pressured to mimic their expenditures.[111] Rather than lowering the cost of a college degree, "such a policy might ultimately

104. *See* Wolf, *supra* note 8, at 591–92 ("The proposal that gained the widest traction would have required universities to spend at least five percent of their assets each year—a 'mandatory payout.'").

105. *Id.*

106. *See, e.g.*, Charles E. Grassley, *Wealthy Colleges Must Make Themselves More Affordable*, CHRON. HIGHER EDUC. (D.C.), May 30, 2008, at A36 [hereinafter Grassley Press Release 2], *available at* http://www.finance.senate.gov/newsroom/ranking/release/?id=c1b59ac6-5fb9-4770-8050-10c4e99d8b1e (arguing that a five-percent distribution rule is not too prescriptive for universities because private foundations must meet this same requirement, and they are "thriving").

107. *See, e.g.*, RICHARD VEDDER, CTR. FOR COLL. AFFORDABILITY & PRODUCTIVITY, FEDERAL TAX POLICY REGARDING UNIVERSITIES: ENDOWMENTS AND BEYOND 15 (2008), *available at* http://www. centerforcollegeaffordability.org/uploads/Endowment_Report.pdf ("A 5 percent spending rule seems extremely conservative.").

108. The average spending rate across all higher-education institutions in 2011 was 4.6% of endowment value. NAT'L ASS'N OF COLL. & UNIV. BUS. OFFICERS & COMMONFUND INST., 2011 NACUBO-COMMONFUND STUDY OF ENDOWMENTS: AVERAGE ANNUAL EFFECTIVE SPENDING RATES, 2011 TO 2002 (2012), *available at* http://www.nacubo.org/Documents/research/ 2011_NCSE_Public_Tables _Spending_Rates_Final_January_18_2012.pdf.

109. *See, e.g.*, Waldeck, *supra* note 8, at 1816 ("Although proponents of mandatory spending see it as a means of reducing tuition, a five-percent rule may affect a university's spending priorities, sometimes in ways that are contrary to the overarching goal of controlling tuition."); Wolf, *supra* note 8, at 622 ("[T]he payout will have harmful consequences, including accelerating the academic arms race . . . and hindering colleges' ability to respond to economic fluctuations.").

110. VEDDER, *supra* note 107, at 20 (emphasis omitted); *see also* Wolf, *supra* note 8, at 613–14 ("The term 'arms race' in the academic context typically refers to the competition between schools to attract the top students by providing the best educational opportunities—as well as the best dormitories, dining halls, and athletic facilities (although some have also used the term more generally to explain the competition for top faculty and, in the end, for prestige).").

111. VEDDER, *supra* note 107, at 20.

increase the use of resources by society for higher education, with dubious payoffs in terms of outcomes."[112]

Moreover, there is concern that a spending requirement simultaneously demands too much and too little from universities, depending on their particular circumstances. During periods of poor investment performance, for example, a five-percent rule could lead "to real endowment declines at many American institutions."[113] On the other hand, while the requirement is "intended to act as a floor for spending," some fear it could become "a ceiling, with institutions opting never to spend at a higher rate."[114]

Perhaps more important, a spending rule could create awkward internal conflicts for universities. It seems doubtful that such a rule would change higher education's preoccupation with endowment building, for example, which means schools may seek additional sources of revenue to make up for their extra spending.[115] This could tempt otherwise-conservative universities to engage in risky endowment management strategies or, worse, simply "rais[e] tuition across the board."[116]

B. Taxing Large Endowments

An alternative to the five-percent spending rule is to tax the endowment income of wealthy schools.[117] Based on an average investment return of 15.3%, a 2007 study found that applying a 35% income tax rate to the 765 university endowments included in the study could result in $18 billion in annual federal revenue.[118] Under one

112. *Id.*

113. *Id.* at 16.

114. Wolf, *supra* note 8, at 620.

115. *See* Waldeck, *supra* note 8, at 1815 ("Even in a world of mandatory spending, universities are likely to try to maintain the size of their endowments.").

116. *Id.*

117. *See id.* at 1817 ("Another idea is to make endowment investment returns subject to the corporate income tax."). Some scholars have also discussed the possibility of combining taxes with spending requirements. *See, e.g.*, VEDDER, *supra* note 107, at 21 ("For example, if college A faces a 5.4 percent spending requirement from its endowment but spends only 4.4 percent, a 20 percent tax on the difference between 4.4 and 5.4 percent (0.2 percent of the endowment's value) could be imposed."). A few policymakers have even proposed going a step further and simply imposing assessments based on total endowment value, whether or not a university's wealth is growing or shrinking. *See* Schworm & Viser, *supra* note 10 (describing a Massachusetts plan that would have applied a 2.5% assessment on university endowments worth more than $1 billion).

118. JANE G. GRAVELLE, CONG. RESEARCH SERV., TAX ISSUES AND UNIVERSITY ENDOWMENTS 3 (Aug. 20, 2007) [hereinafter GRAVELLE MEMORANDUM],

proposal, Congress could develop a revenue-sharing plan and use this money to curb the higher-education wealth gap.[119] A less complicated suggestion is to earmark the funds for financial aid.[120]

Unfortunately, while these proposals offer advantages that mandatory distribution requirements fail to provide,[121] they also raise concerns regarding potential unintended consequences. Critics have argued, for example, that if Congress uses tax revenue to fund federal financial-aid programs, schools "can capture the benefit by raising tuition or by offsetting internal financial aid (or both)."[122]

To illustrate, assume that tuition at College A is $2,000 per year. If Congress gives students a 100% tax credit for the first $3,000 they spend annually in tuition and fees, College A can raise its rates by $1,000 at no cost to its students.[123] While this may help poorer schools close the institutional-wealth gap, scholars fear such a transfer of federal-tax dollars to public colleges will discourage state funding of higher education.[124] Moreover, the side effect of higher tuition rates could actually fuel additional university spending in other areas. According to one study of public colleges, "every $1 in higher tuition charges is associated with roughly $2 in higher salaries for full professors."[125]

More broadly, proposals for both mandatory-payout requirements and endowment taxes involve uncomfortable and potentially arbitrary decisions about universities' relative wealth.[126] Policymakers have indicated, for example, that "[a]ny legislation would probably apply only to institutions with absolute endowments valued above a certain floor,

http://www.finance.senate.gov/news room/ranking/download/?id=f2ca39c7-f9e7-4ce0-8e76-2918f9758087.

119. Herbert A. Allen, Op-Ed., *Gold in the Ivory Tower*, N.Y. TIMES (Dec. 21, 2007), http://www.nytimes.com/2007/12/21/opinion/21allen.html.

120. *See* Waldeck, *supra* note 8, at 1817 ("The most straightforward [plan] would earmark the funds generated for congressional measures designed to alleviate tuition costs.").

121. *See id.* (noting that the tax would apply only when investments produced a profit and would not require universities to dip into underwater endowment funds).

122. Evelyn Brody, *Charities in Tax Reform: Threats to Subsidies Overt and Covert,* 66 TENN. L. REV. 687, 709 (1999).

123. *See id.* at 709 n.86 (discussing essentially the same example).

124. *See* Michael S. McPherson & Morton Owen Schapiro, *Financing Undergraduate Education: Designing National Policies*, 50 NAT'L TAX J. 557, 564 (1997) (discussing a similar proposal by President Clinton and concluding that it could "create an environment that encourages further withdrawal of state support").

125. VEDDER, *supra* note 107, at 19.

126. *See* Waldeck, *supra* note 8, at 1799 ("With such a wide range of endowment values, one threshold question is: which institutions are truly wealthy?").

such as $500 million or $1 billion."[127] But focusing on absolute endowment size is problematic because research expenses, enrollment numbers, and tuition rates vary greatly by school.[128] Proposals based on an "endowment-to-expense" ratio would produce fairer results, but this basis has problems of its own, partly because universities could easily manipulate data to avoid a potential tax or regulation.[129] A few scholars have settled on an "endowment-per-student" ratio as the best of both worlds,[130] but they acknowledge that even this acts as an imperfect measure of relative wealth.[131] Thus, any tax based on endowment size is inherently problematic and could lead to unfair outcomes.

C. Increased Transparency

A less controversial proposal simply calls for more transparency from colleges and universities regarding endowment spending and accumulation practices.[132] The Internal Revenue Service already requires tax-exempt organizations to annually fill out Form 990, which includes questions regarding employee compensation, revenue, and expenses,[133] but some policymakers argue that the form should be amended to require more endowment-specific information.[134]

127. Wolf, *supra* note 8, at 599.

128. As Professor Waldeck notes, "[t]he primary value of an endowment stems from its ability to subsidize university operations." Waldeck, *supra* note 8, at 1800. Thus, the smaller the college, and the less ambitious its research agenda, the less total endowment it needs.

129. *See id.* at 1801 ("[O]ne can . . . imagine a series of Enron-like maneuvers designed to manipulate the ratio.").

130. VEDDER, *supra* note 107, at 13 ("The size of endowment needs to be related to the size of the student body to ascertain resources available per student."); *see* Wolf, *supra* note 8, at 1802 ("As Congress considers which institutions genuinely have an excessive endowment, the amount of endowment per full-time student will be its most useful measure.").

131. *See, e.g.*, Waldeck, *supra* note 8, at 1801 ("[T]he measure is not as sensitive [to institutional costs] as the endowment-expense ratio.").

132. *See, e.g.*, GRAVELLE MEMORANDUM, *supra* note 118, at 14 ("Disseminating better information on what higher-education institutions are doing with their endowments . . . could be helpful.").

133. INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, 2011 INSTRUCTIONS FOR FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX 22, 33, 38 (2011), *available at* http://www.irs.gov/pub/irs-pdf/i990.pdf.

134. *See* Grassley Press Release 1, *supra* note 11 ("The public needs to understand clearer what is the endowment of the charity . . . ; what those endowment funds are being spent on; the amount and percentage of the endowment being spent; how those endowment funds are being invested; the size of the endowment; what endowment funds are earmarked for specific purposes and what are those purposes; and, the costs of the management of the endowment.").

There is nothing particularly problematic about such proposals (although the more information required of universities, the more money they will be forced to divert from educational pursuits to regulatory compliance).[135] In fact, universities might feel pressured to distribute more of their endowment income if they know the public has access to information about the way they manage their wealth.[136] It is not clear, however, that more transparency, by itself, would have a significant effect on educational access or tuition costs.[137]

There may even be a slight danger that increased transparency could prompt more endowment accumulation. Given university administrators' inclination toward preserving endowment corpus,[138] they may be interested to know how little they can spend without falling out of line with peer institutions. This could spark a race to the bottom in higher education.

D. Changes in Donor Tax Laws

A more creative proposal focuses on indirectly influencing endowment spending by targeting donors. Professor Waldeck has suggested, for example, that Congress could deny tax deductions for gifts to universities that are restricted for more than twenty-five years.[139] It could also cap deductions on donations for buildings, machinery or other amenities that fuel spending arms races.[140] The combined effect of these changes, she argues, would be to "encourage present spending and help direct donors away from gifts that may inadvertently contribute to the rising costs of education."[141]

135. *See* Stephanie Strom, *I.R.S. Seeks More Charity Transparency*, N.Y. TIMES (Jun. 15, 2007), http://www.nytimes.com/2007/06/15/washington/15charity.html (quoting Trent Stamp, president of Charity Navigator) ("Greater transparency will mean more work for charities . . . ."); *cf.* Waldeck, *supra* note 8, at 1816 ("While a revised Form 990 may cost more to complete, such expenditures are unlikely to be a significant factor in a university budget.")

136. Waldeck, *supra* note 8, at 1816; *see also* Cowan, *supra* note 14, at 552 ("[A]dditional disclosure requirements could pressure colleges and universities to better monitor their endowment policies.").

137. *See, e.g.*, Koltko, *supra* note 97, at 1098 ("It is unreasonable to expect necessary changes in the operation of law simply from a more detailed report to the enforcement authority.").

138. See *supra* notes 70–85 and accompanying text.

139. Waldeck, *supra* note 8, at 1818. She would only deny deductions for gifts to "mega-endowment institution[s]." *Id.*

140. *Id.* at 1818–19.

141. *Id.* at 1818.

The legal community has largely ignored this solution,[142] most likely because it has the potential to decrease the overall pool of money available for higher education. Professor Waldeck admits that her proposals could "cause some donors to reevaluate whether to give to mega-endowment universities," but she points to the many noneducational charities that could receive donations in these schools' stead.[143] The problem is that this argument ignores the very reason for considering endowment-related reforms in the first place. Endowment building has become controversial only because schools have failed to meaningfully restrain the rising costs of a college education.[144] The fact that some schools may be "hoarding" endowment income does not mean that higher education as a whole is overfunded. [145] On the contrary, concerns over rising tuition and decreased state funding evidence the need for more donations, not fewer.[146] To enact reforms that divert money away from colleges and universities would only make education more expensive for students.

142. *See id.* ("Neither Congress nor commentators have identified donors as a potential means of encouraging endowment spending . . . . The relative silence about donors is curious."). *But see* VEDDER, *supra* note 107, at 18 ("Those wanting incremental endowment spending to meet instructional or research needs could achieve their objective by restricting tax-exempt donations and investment income to those areas.").

143. Waldeck, *supra* note 8, at 1822.

144. *See* GRAVELLE MEMORANDUM, *supra* note 118, at 1 (noting that the memorandum was in response to requests for information regarding endowment growth and how distributions from endowments could slow tuition increases); Cowan, *supra* note 14, at 508 ("[S]ome have called on colleges and universities to stop 'hoarding' their endowment income and to begin using the funds to increase student aid and limit tuition increases."); Karen W. Arenson, *Senate Looking at Endowments as Tuition Rises*, N.Y. TIMES (Jan. 25, 2008), http://www.nytimes.com/2008/01/25/education/25endowments.html ("The Senate Finance Committee, increasingly concerned about the rising cost of higher education, demanded detailed information . . . from . . . universities on how they . . . managed and spent their endowments.").

145. *See Offshore Tax Issues, Reinsurance and Hedge Funds: Hearings Before the S. Comm. on Finance*, 110th Cong. 15 (2007) [hereinafter Finance Committee Hearing] (statement of Lynne Munson, Center for College Affordability and Productivity), *available at* http://www.finance.senate.gov/hearings/hearing/?id=ddb36aa0-beb0-e2f8-275e-13625c509939 ("[I]n too many cases, this wealth is being hoarded instead of shared.").

146. *See* MARCEL HERBST, FINANCING PUBLIC UNIVERSITIES: THE CASE OF PERFORMANCE FUNDING 3 (2009) ("The prospects for higher education funding are generally dim: costs of higher education often rise faster than inflation; and economic development and . . . state revenues from taxes . . . are lagging behind because of the traditionally long periods which separate investments in education from subsequent economic prosperity."); Dillon, *supra* note 25 ("Taxpayer support for public universities, measured per student, has plunged more precipitously since 2001 than at any time in two decades . . . .").

E. The Need for a New Solution

The foregoing proposals share a common defect: they are unlikely to significantly impact the affordability of higher education. In fact, in many cases, they could result in larger tuition bills for students. Effective congressional reform, if it is possible, must include measures that increase educational access.[147] At the same time, to be consistent with the theory of intergenerational equity, endowment legislation should not unnecessarily inhibit universities' ability to save for the future. The next section discusses a potential solution designed to satisfy both of these criteria.

IV. A PROPOSED SOLUTION

Few scholars have addressed the possibility of linking an endowment tax to increases in tuition,[148] but this measure could offer many of the benefits of the foregoing proposals while avoiding a number of their major drawbacks. This section sets forth the mechanics of such a tax in detail and discusses both its unique advantages and potential weaknesses. While any endowment-related regulation is sure to attract opposition from those who benefit from the status quo in higher education, the arguments supporting this solution merit additional consideration by both academics and policymakers.

A. A Tuition-Driven Tax

Part of the appeal of linking an endowment tax to tuition is its simplicity. Rather than draw arbitrary lines separating "wealthy" and "other" universities or debate about the basis used to draw those lines,[149]

147. *See* Grassley Press Release 2, *supra* note 106 ("[C]olleges are obliged to carry out the charitable purpose of providing the best education *to the most students at the lowest cost.*") (emphasis added).

148. Jane Gravelle briefly mentioned the possibility in a Congressional Research memo in August 2007, and again at a hearing before the Senate Finance Committee a month later. *See* GRAVELLE MEMORANDUM, *supra* note 118, at 15 ("Taxes could also be imposed on endowments if institutions increased their tuition by more than an appropriate rate such as inflation . . . ."); Finance Committee Hearing, *supra* note 145, at 15 ("Another option, if the public policy concern is about affordable education, would be to impose a tax on the endowment for schools with tuition increases over a pre-determined threshold."). These comments attracted little attention from other commentators, however, who have remained much more focused on the proposals discussed in Part III, *supra*.

149. *See supra* notes 126–31 and accompanying text.

the government would simply tax all schools[150] that increase tuition by more than inflation in the same year that their endowments grow.[151] Conversely, as long as tuition increases do not outpace inflation,[152] universities could accumulate endowment income tax-free, with no minimum spending requirement.[153] Likewise, if poor economic conditions cause endowment values to decrease, schools could use tuition increases to help weather the storm without incurring tax liability.[154] The government could make reporting, monitoring, and enforcement relatively simple by revising Form 990.[155]

Perhaps Congress's most challenging task would be to define "endowment" broadly to include schools' "total reserve funds."[156] A typical endowment is made up of "thousands of separate accounts with specific, designated purposes,"[157] and an endowment tax could provide a

150. The tax would apply to both private and public universities. At first glance, this might appear to implicate federalism concerns, since public colleges are "exempt from the federal income tax by virtue of being part of the state government." Cowan, *supra* note 14, at 511. As Cowan points out, however, "[t]he private/public distinction . . . is not particularly critical when analyzing whether endowment income should be taxed or regulated," in part because public universities' endowments "are normally not held by the state institutions themselves. Rather, endowments are raised, managed, and distributed by 'supporting organizations' that independently qualify for tax exemption as § 501(c)(3) organizations." *Id.* at 511–12.

151. Ideally, inflation would be measured using a government-compiled index, such as the Consumer Price Index. Vedder notes that "[c]olleges and universities argue for using the Higher Education Price Index" (HEPI), but he calls this "totally inappropriate" since this index "is largely determined by input prices in higher education." VEDDER, *supra* note 107, at 17. The problem with HEPI is that when administrative costs go up—because schools give employees excessive pay raises, for example—HEPI also rises. Colleges could thus use it to "claim that 'higher education costs are soaring,' and demand larger government subsidies." *Id.*

152. During periods of deflation, the legislation should probably require only that universities keep tuition rates flat; demanding tuition decreases could be problematic from a planning and budgeting standpoint. In any case, this point is of little consequence; since 1950, the average year-to-year Consumer Price index has declined only twice. *See* BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CONSUMER PRICE INDEX HISTORY TABLE, *available at* ftp://ftp.bls.gov/pub/special.requests/cpi/ cpiai.txt.

153. Congress may also need to include provisions that prevent schools from avoiding the tax by substituting higher room and board charges for tuition increases. *See* GRAVELLE MEMORANDUM, *supra* note 118, at 16 ("Such approaches would probably also have to extend to room and board, to prevent increasing these payments as a substitute."). Room and board increases arguably do not pose as serious a threat as tuition hikes, however, since students at many schools can opt to live off campus.

154. Thus, unlike proposals for mandatory payouts—which require minimum levels of spending regardless of endowment performance—this tax would protect universities whose investments perform poorly.

155. *See supra* notes 133–34 and accompanying text.

156. *See supra* note 42 and accompanying text.

157. Cowan, *supra* note 14, at 522.

perverse incentive for colleges and universities to rearrange these accounts in creative ways or revise their own definitions of what constitutes endowment funds in order to avoid application of the tax. A potential solution would be to use the definition of "endowment" in IRS Form 14018 as a model.[158]

The government distributed Form 14018 to 400 colleges and universities in 2008 in an effort to obtain detailed information regarding how the schools manage their financial affairs.[159] The form adopts an overarching, and somewhat circular, definition of endowment assets to encompass "the total of all long-term endowments held for the institution's benefit including those held by others such as foundations."[160] It then divides "endowments" into three categories: (1) "true endowments," defined as "gifts to the endowment pool of which only the return on the principal investment can be spent"; (2) "quasi endowments," defined as endowment funds "of which the principal can be spent at the discretion of the institution's trustees"; and (3) "term endowments," defined as endowment funds "of which the principal can be spent after its defined 'term' has passed."[161] Because these three categories essentially capture all restricted and unrestricted endowment funds, this definition would make it difficult for universities to avoid the tax by redefining or rearranging their endowment accounts.[162]

In most instances, limiting tuition increases would represent universities' least expensive response to the tax.[163] Where exceptions

158. *See* INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, FORM 14018: COMPLIANCE QUESTIONNAIRE COLLEGES AND UNIVERSITIES 21 (2008), *available at* http://www.irs.gov/pub/irs-tege/sample_cucp_questionnaire.pdf [hereinafter FORM 14018].

159. MALVERN J. GROSS, JR. ET AL., FINANCIAL AND ACCOUNTING GUIDE FOR NOT-FOR-PROFIT ORGANIZATIONS 224 (7th ed. Supp. 2010).

160. FORM 14018, *supra* note 158, at 21.

161. *Id.*

162. A potential alternative would be to simply define a university's "endowment" to include all money invested in a common pool with "true endowment" funds. Because most schools group endowment accounts together and manage them as a single investment pool, Cowan, *supra* note 14, at 522, and because a large portion of this pool is likely to be made up of "true endowment" funds, this approach would probably capture the vast majority of schools' total reserve funds. Institutions hoping to avoid the tax by rearranging their accounts would be forced to remove unrestricted money from the pool and forego the investment benefits it provides. Because they could respond by creating a second investment pool for unrestricted funds, however, the definition in Form 14018, while more cumbersome, is arguably less problematic.

163. *See* GRAVELLE MEMORANDUM, *supra* note 118, at 15–16 ("[T]he tax could easily be small and yet induce institutions to cut back tuition increases. . . . [A] tuition increase for Harvard was only 0.1% of its endowment, so it would clearly prefer to limit tuition increases rather than be exposed to even a small endowment tax."). Tuition increases at all thirty schools which Gravelle

exist, however, Congress could assess endowment income at the federal corporate rate. Because this rate is progressive,[164] less wealthy colleges with smaller investment returns would pay less tax than schools like Harvard and Yale.

Unlike other proposals,[165] the point of this solution is not to generate substantial tax revenue from university endowments, but rather to encourage endowment behavior that promotes educational access. Nevertheless, Congress could use what little funding the measure might produce to develop a revenue-sharing plan designed to benefit the neediest institutions.[166] This would "allow the poor schools back into the competition for the best teachers and students" with only minimal impact on wealthy universities.[167] It would also give poor colleges that pay the tax a chance to regain a portion of their losses.

B. Advantages

Linking an endowment tax to tuition increases offers several unique advantages. Like the other proposals discussed in Part III, the tax would encourage universities to distribute more of their wealth, but unlike those proposals, it would focus that distribution on college affordability. This would de-incentivize spending "arms races"[168] by prioritizing tuition ahead of expenditures less related to universities' educational missions, such as adding luxury facilities and other costly amenities to their campuses. It is not that schools would be unable to undertake such projects; rather, they would merely need to ensure that students were not forced to pay higher tuition prices in order to fund them.

At the same time, this proposal would still allow for significant endowment accumulation. This is important not only because universities claim it is necessary to provide equivalent services to future students,[169] but also because it is unlikely that any legislation could

surveyed were less than one percent of their respective endowments. *Id.* at 13–14.

164. *See* 26 U.S.C. § 11(b) (2012).

165. *See supra* notes 117–20 and accompanying text.

166. As one commentator has suggested, for example, the tax revenue could be distributed pro rata to institutions with endowments below a certain base level. Allen, *supra* note 119. "The college with the lowest per student endowment would get the highest share." *Id.* This would be a better use of the money than earmarking it for federal grants or financial aid, since such programs can create incentives for schools to increase tuition rates. *See supra* notes 122–23 and accompanying text.

167. Allen, *supra* note 119.

168. *See supra* notes 110–12 and accompanying text.

169. *See* Tobin, *supra* note 53, at 427 ("The trustees of an endowed institution are the guardians of the future against the claims of the present.").

remove higher education's preoccupation with endowment growth. Proposals that attempt to do so create awkward internal conflicts.[170]

This leads to perhaps the most persuasive argument in support of this solution: it helps universities more closely align their behavior with principles of intergenerational equity. If higher-education institutions are "immortal," as Tobin suggests,[171] they have a legitimate interest in saving for the future. Thus, it is important not to cut off their ability to preserve and even build endowment corpus. At the same time, intergenerational equity seems to demand that endowment building not result in decreased educational access for current students.[172] In fact, if anything, endowment policies should reflect a preference for present students because history has shown that donations are likely to continue to flow into university coffers in the future,[173] and prosperity should increase among later generations.[174] Linking an endowment tax to tuition appropriately shifts the focus to current students by ensuring that universities will not grow rich at their expense. On the other hand, it maintains a healthy intergenerational balance by allowing for endowment building once the school ensures that current students will pay no more for their education, in real dollars, than their predecessors.

C. Criticisms and Counterarguments

It is difficult to predict all possible criticisms of this proposal, because it has received little attention in legal literature. Nonetheless, it seems likely that opponents would focus on the issues addressed below. While this solution would not fully resolve all concerns, as this discussion illustrates, the arguments supporting this tax are strong enough to merit further consideration among policymakers.

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170. *See supra* notes 115–16 and accompanying text.

171. *See* Tobin, *supra* note 53, at 427.

172. If well-endowed schools that cut operational budgets during recessions "violate[] the intergenerational equity pledge," logic would suggest that schools commit the same violation when they raise tuition by more than inflation, especially if they do so while their wealth—and consequently their capacity to serve the needs of future students—is growing. Conti-Brown, *supra* note 13, at 708; *see also supra* notes 58–61 and accompanying text.

173. *See* Hansmann, *supra* note 13, at 16 ("[T]here is no reason to ignore the prospect of future gifts to endowment in undertaking an intergenerational welfare analysis.").

174. *See id.* at 14 ("There is every reason to believe that, over the long run, the economy will continue to grow in the future as it has in the past and that future generations of students will therefore be, on average, more prosperous than students are today. . . . Thus . . . it would seem more equitable to have future generations subsidize the present.").

1. Effect on needy students

Critics might argue that by keeping tuition rates low, this proposal could actually hurt the nation's neediest students. Many institutions fund financial aid packages for the indigent with money paid by those wealthy enough to afford their school's full sticker price.[175] Well-endowed colleges raise tuition rates regularly, the argument goes, but only the wealthiest students and families receive no financial aid.[176] Thus, opponents could claim that reducing the price of admission at the top end will simply leave less money available for other students.

There are two problems with this analysis, however. First, the rising number of college graduates burdened by excessive student loan debt suggests that if universities are doling out financial aid to students in need, [177] they are either not giving enough or leaving a large segment of their students—most likely from middle-class families—unaided.[178] If tying an endowment tax to tuition means slightly less financial aid for those who could have otherwise attended school tuition-free, it should also mean lower tuition costs—and therefore less student-loan debt—for those with just enough income to be ignored by current financial-aid programs.[179]

Second, the combination of increased tuition rates and less-than-transparent financial-aid practices makes the task of financing a college education an unnecessarily confusing one for many families. As one

175. *See* Kevin Kiley, *Occupy Someone Else*, INSIDE HIGHER ED (Dec. 9, 2011, 3:00 AM), http://www.insidehighered.com/news/2011/12/09/public-universities-question-why-they-not-lawmakers-are-protesters-target ("Essentially, wealthy students who pay full tuition subsidize the cost of educating low-income students.").

176. The University of California, for example, will cover the full cost of tuition and fees for students who are California residents and come from families earning less than $80,000 per year. *The Blue+Gold Opportunity Plan*, UNIVERSITY OF CALIFORNIA (Nov. 18, 2010), http://www.universityofcalifornia.edu/admissions/paying-for-uc/financial-aid/grants/blue-gold/files/blueandgold_factsheet_11_Eng.pdf.

177. A 2010 study showed that only about one-third of college students graduate without debt (and the fraction may be even smaller when factoring in the number of parents who borrow to pay for their children's education). Tamar Lewin, *College Graduates' Debt Burden Grew, Yet Again, in 2010*, N.Y. TIMES (Nov. 3, 2011), http://www.nytimes.com/2011/11/03/education/average-student-loan-debt-grew-by-5-percent-in-2010.html. For the two-thirds who do take out student loans, the average debt load has surged to a record high of $25,250 per graduate. *Id.*

178. *See* Kiley, *supra* note 175 ("[O]nly a handful of institutions meet full need for all students, and even those . . . campuses that try to meet need for low-income student[s] still leave many squeezed in the middle.").

179. Universities, of course, would be free to use more endowment income to make up the difference for the students they believe are hurt by the tax.

observer lamented, "colleges have adopted complicated aid programs and discounts that have made the pricing of an undergraduate education at an elite college as complicated and varied as the pricing of airline seats."[180] The effects of this reality go well beyond mere annoyance. For instance, as Senator Charles Grassley (R-Iowa) has pointed out, high tuition prices cause "[s]tudents from low-income families [to] fear they won't be able to afford college, some so much that they don't even apply."[181] Even if linking an endowment tax to tuition reduces financial aid, if the tax fosters more transparency from colleges regarding the true costs of an education, it could actually increase the number of low-income students who attend.

2. Tuition increases during recessions

Another potential criticism is that this tax would encourage tuition hikes during economic downturns. That is, while the tax may help keep costs down when endowments are growing, some might argue that universities will seek to make up for this by raising rates when endowments shrink.

Admittedly, the tax would do nothing to discourage tuition increases during years of shrinking endowment funds, but it is important to note that universities already have track records of drastically raising their rates during recessions. In fact, one study has shown that "[t]he steepest increases in public college and university tuition have been imposed during times of greatest economic hardship."[182] From 2008 to 2009, for example, just as Americans were feeling the effects of "the once in a century financial crisis,"[183] published tuition and fees increased 6.5% at both public four-year institutions and private for-profit institutions and 4.4% at private not-for-profit schools, despite a 2.1% drop in the Consumer Price Index over the same period.[184] Higher-education institutions raised their rates by similar percentages from 2009 to

180. Arenson, *supra* note 144, at 2.

181. Grassley Press Release 2, *supra* note 106.

182. NAT'L CTR. FOR PUB. POL'Y AND HIGHER EDUC., LOSING GROUND: A NATIONAL STATUS REPORT ON THE AFFORDABILITY OF AMERICAN HIGHER EDUCATION 4 (2002), *available at* http://www.highereducation.org/reports/losing_ground/affordability_report_final.pdf.

183. Conti-Brown, *supra* note 13, at 709 (internal quotation marks omitted).

184. SANDY BAUM & JENNIFER MA, COLL. BD. ADVOCACY & POLICY CTR., TRENDS IN COLLEGE PRICING 2009, at 2 (2009), *available at* http://trends.collegeboard.org/downloads/archives/CP_2009.pdf.

2010.[185] Linking an endowment tax to tuition may not discourage rising costs during economic downturns, but it seems unlikely to create problems that students do not already face under the current system.

Of course, some might argue that tuition increases would simply be more severe as a result of the tax,[186] but variations in endowment performance should militate against this possibility. At the end of the 2008 fiscal year, for example, twenty-six of the nation's forty wealthiest universities reported that their endowments grew over the previous twelve months, despite the recession being in full force.[187] Under the proposal suggested here, these schools would have been forced to limit tuition increases, which may have prompted poorer-performing schools to do the same.

Moreover, at some point, extreme tuition hikes do more damage than good for colleges' bottom line. Research has shown that "[h]igher education is like most goods and services in our economy—as its price rises, individuals are likely to consume less of it."[188] In fact, according to one recent study, "especially large tuition increases elicit disproportionate enrollment responses."[189] These responses have not

185. *See* SANDY BAUM & JENNIFER MA, COLL. BD. ADVOCACY & POLICY CTR., TRENDS IN COLLEGE PRICING 2010, at 3, 9 (2010), *available at* http://www.naicu.edu/docLib/20101027_CollBd2010Pricing.pdf (noting that in-state and out-of-state tuition at four-year public universities rose by 7.9% and 6.0%, respectively, while tuition at private schools rose by 4.5%, all despite a meager 1.2% increase in the CPI).

186. In a related vein, critics might argue that if Congress enacted this proposal, universities would respond by raising tuition in accordance with inflation every year, regardless of their operational needs. The tax obviously does nothing to preclude this possibility, but it should not necessarily be considered a negative result. If drastic tuition increases violate principles of intergenerational equity, *see supra* note 172, one could argue that real decreases in the cost of attendance do the same. In any case, given current trends in higher education, regular tuition increases that mirror inflation would actually represent a vast improvement for most students in terms of the overall affordability of a college degree. *See* BAUM & MA, *supra* note 4, at 3 (noting that over the past decade, published tuition and fees have increased at an average rate of 5.6%, 3.8%, and 2.6% beyond the rate of inflation at public four-year schools, public two-year colleges, and private four-year institutions, respectively).

187. NAT'L ASS'N OF COLL. & UNIV. BUS. OFFICERS & COMMONFUND INST., 2008 NACUBO ENDOWMENT STUDY, ALL INSTITUTIONS LISTED BY FISCAL YEAR 2008 MARKET VALUE OF ENDOWMENT ASSETS WITH PERCENTAGE CHANGE BETWEEN 2007 AND 2008 ENDOWMENT ASSETS 1 (2009), *available at* http://www.nacubo.org/documents/research/NES2008PublicTable-AllInstitutionsByFY08MarketValue.pdf.

188. DONALD E. HELLER, EDFUND, THE EFFECTS OF TUITION PRICES AND FINANCIAL AID ON ENROLLMENT IN HIGHER EDUCATION: CALIFORNIA AND THE NATION 8 (2001), *available at* http://www.eastwestcenter.org/fileadmin/resources/education/ed2020_docs/Heller-effects_of_tuition_and_financial_aid_-_pdf.pdf.

189. Steven W. Hemelt & Dave E. Marcotte, *The Impact of Tuition Increases on Enrollment at Public Colleges and Universities*, 33 EDUC. EVALUATION AND POL'Y ANALYSIS 435, 435 (2011).

been significant enough to stop universities from raising tuition, but they could act as a cap on the most severe increases.

3. Donor restrictions tie up endowment funds for purposes unrelated to tuition

Opponents might also argue that some universities would be unable to avoid the tax because too much of their endowments are restricted for purposes unrelated to tuition. In fact, higher-education institutions have long pointed to this argument as a reason for not spending more of their wealth to increase educational access.[190]

As mentioned above, however, research suggests that donor restrictions do not meaningfully restrain endowment spending.[191] Studies show, for example, that 45% of endowment funds at private universities and 20% at public institutions are unrestricted.[192] Even ignoring the portions of restricted endowment that are designated for financial aid or tuition-related purposes,[193] this should leave most colleges and universities with more than enough money to keep tuition in line with inflation. As one study noted, "small additional distributions from institutions' endowments"—in some cases as little as one-half of one percent of the total endowment value—"could mitigate or eliminate tuition growth" at many universities.[194]

Of course, a few schools have endowments with much larger percentages of restricted funds,[195] but this reality raises an important

190. *See* Conti-Brown, *supra* note 13, at 722 ("Many have argued that . . . restrictions keep universities from spending their endowments as liberally as they would like . . . ."); Waldeck, *supra* note 8, at 1808 ("Even if an institution wanted to . . . provide free tuition for every student, it could not tap all of its endowment to do so; some of the funds would be restricted for . . . uses that are far removed from free tuition.").

191. *See supra* Part II.B.1.

192. Waldeck, *supra* note 8, at 1808–09 (citing NAT'L ASS'N OF COLL. & UNIV. BUS. OFFICERS & COMMONFUND INST., 2006 NACUBO ENDOWMENT STUDY 61–90 (2007), *available at* http://www.nacubo.org).

193. According to one study, "financial aid is the number one restriction chosen by donors—outpacing all other areas, including research, athletics, and faculty salaries combined." Lynne Munson, *Endowment Reform: Why Universities Should Share Their Vast Wealth and in the Process Make Higher Education More Affordable*, *in* UNIVERSITY ENDOWMENT REFORM: A DIALOGUE 12 (2008), *available at* http://www.policyarchive.org/handle/10207/bitstreams /20599.pdf.

194. GRAVELLE MEMORANDUM, *supra* note 118, at 12.

195. At the University of Texas, for example, only 0.5% of the institution's multi-billion-dollar endowment is unrestricted. Charles Miller, *Endowment Reform: Why Federal Mandatory Payouts Are Unnecessary, Legally Dubious, and Counterproductive to Larger Higher Education Reform*, *in* UNIVERSITY ENDOWMENT REFORM: A DIALOGUE 9 (2008), *available at* http://www.policyarchive.org/handle/10207/bitstreams/20599.pdf.

point about university fundraising. Scholars tend to agree that schools have significant influence over the restrictions that donors apply to gifts.[196] As an example, economist Richard Vedder points to a recent donation by former eBay CEO Meg Whitman, who helped Princeton University build a residential facility with a price tag of more than $300,000 per bed—"roughly the cost of a luxury hotel of the Ritz-Carlton variety."[197] Whitman could have restricted the money for tuition assistance, but as Vedder explains, "Princeton no doubt told her 'we need this luxury facility to help lure students here that would otherwise go to Harvard or Yale.'"[198] A tuition-triggered endowment tax may force schools to modify their fundraising practices, but in many cases this would lead to both increased educational access and more efficient use of society's resources.

4. Tying the tax to tuition ignores the importance of research

Critics could argue that tying the tax solely to tuition ignores the valuable contribution that endowment income makes to vital research programs. Along with instructing students, conducting research has traditionally been viewed as one of the central functions of higher education,[199] and the schools with the largest endowments are usually the ones that support the most research.[200] Opponents may fear that as more endowment income is directed toward keeping tuition costs low, universities will feel compelled to cut funding for important research-related initiatives.

To the extent that this fear exists, however, it seems largely

196. *See, e.g.*, Waldeck, *supra* note 8, at 1809 ("[T]here is reason to suspect . . . that the restrictions are partially of the university's own making."); Ronald G. Ehrenberg & Christopher L. Smith, *The Sources and Uses of Annual Giving at Private Research Universities* 5 (Nat'l Bureau of Econ. Research, Working Paper No. 8307, 2001), *available at* http://www.nber.org/papers/w8307 ("[T]he major private research universities devote considerable resources to cultivating donors and 'shaping' their giving preferences.").

197. VEDDER, *supra* note 107, at 20.

198. *Id.*

199. *See, e.g.*, John Hattie & H.W. Marsh, *The Relationship Between Research and Teaching: A Meta-Analysis*, 66 REV. EDUC. RES. 507, 507 (1996) ("The claim that universities exist for teaching and research seems incontrovertible to many . . . .").

200. For example, of the twenty-five top American research universities, as ranked by The Center for Measuring University Performance, twenty-four have endowments worth more than $1 billion. ELIZABETH D. CAPALDI ET AL., CTR. FOR MEASURING UNIV. PERFORMANCE, THE TOP AMERICAN RESEARCH UNIVERSITIES: 2010 ANNUAL REPORT 16 (2010), *available at* http://mup.asu.edu/research2010.pdf. Of course, that is due in part to the fact that "endowment assets" are included as one of the nine measures the center uses to rank the institutions. *Id.* at 15.

misplaced. Because the tax would be assessed only when endowment wealth increases, it would not encourage—much less force—universities to reduce financial support for current research programs. Of course, it may inhibit schools' ability to save for *additional* future research, but only to the extent that they would otherwise have prioritized funding for research above funding for tuition. Such a limitation, while potentially controversial, seems consistent with higher education's tax-exempt purposes. Colleges and universities qualify for preferential tax treatment because they are "educational" institutions,[201] not research laboratories.[202]

Moreover, while there is little doubt that research enjoys a strong connection to classroom instruction,[203] it seems appropriate for tax law to prioritize educational access above research funding. Not only does the demand for education provide financial support for research, but, to a large degree, research at a university is made meaningful only because of its relationship to students' education. That is not to say that students are the only consumers of research; in fact, the opposite is somewhat true.[204] As education becomes more expensive, however, the pool of potential future researchers is likely to get smaller,[205] and research can be

201. *See* 26 U.S.C. § 501(c)(3) (2012).

202. It is possible that a university's research could help it qualify for tax exemption as a "scientific" organization under § 501(c)(3). *See* James T.Y. Yang, Note, *Collaboration Between Nonprofit Universities and Commercial Enterprises: The Rationale for Exempting Nonprofit Universities from Federal Income Taxation*, 95 YALE L.J. 1857, 1863 n.37 (1986) ("Research activities undertaken by organizations organized and operated primarily for educational purpose may also qualify as scientific activities."). But the increasing tendency among universities to direct their scientific research toward the corporate sphere has prompted scholars to raise questions regarding their tax-exempt status. *See, e.g.*, JENNIFER WASHBURN, UNIVERSITY, INC.: THE CORPORATE CORRUPTION OF AMERICAN HIGHER EDUCATION 167 (2005) ("[T]he question of whether such aggressive, market-oriented behavior is consistent with university's nonprofit mission, and truly warrants public subsidy, is an important one.").

203. Ruth Neumann, *Perceptions of the Teaching-Research Nexus: A Framework for Analysis*, 23 HIGHER EDUC. 159, 161 (1992) (noting agreement among a sample of academics regarding the nexus between teaching and research and the tendency of the two to merge); W. Edwards Deming, Letter to the Editor, *Memorandum on Teaching*, 26 AM. STAT. 47, 47 (1972) ("He who does no research possesses not knowledge and has nothing to teach."); *cf.* Hattie & Marsh, *supra* note 199, at 533 ("It would be difficult to imagine today's university-level teachers not being aware of recent research, although whether they have to also generate this research to be effective teachers is very much questioned by . . . studies on the relationship between teaching and research.").

204. *See* Risa L. Lieberwitz, *The Marketing of Higher Education: The Price of the University's Soul*, 89 CORNELL L. REV. 763, 779–81 (2004) (reviewing DEREK BOK, UNIVERSITIES IN THE MARKETPLACE: THE COMMERCIALIZATION OF HIGHER EDUCATION (2003) (describing the increasing corporate consumption of research)).

205. *See supra* notes 188–89 and accompanying text.

expected to increasingly target corporate, rather than educational, interests.[206] In the long run, higher education will benefit from a policy that encourages universities to save for future research at a pace that does not interfere with educational access.

5. Universities depend on state funding

Perhaps the most persuasive argument against linking an endowment tax to tuition is that public universities are essentially dependent on state funding to meet their operational goals.[207] In fact, in many states, tuition rates are set by legislatures or state boards of education, not university trustees.[208] Even in states where schools enjoy more autonomy, critics might argue that a cut in government support could essentially compel the majority of these schools to raise tuition despite their own best efforts to increase efficiency. An endowment tax that punishes a university for decisions it cannot control could thus be viewed as unfair.

While this concern should not be lightly dismissed, it should also not be overblown. The tax would likely force legislatures to accept more responsibility for the costs of higher education, especially in states where schools lack control over tuition rates. Many observers would consider this a positive change.[209] Moreover, the onus should not be placed entirely on state governments. Universities often create arguably unnecessary challenges for legislators by making questionable financial decisions, particularly when it comes to compensating administrators.[210]

206. *See* Blumberg, *supra* note 100, at 91 ("The fear is that in time universities will resemble nothing more than commercial research centers.").

207. *See* Hill, *supra* note 14, at 600 ("Universities could not meet their operating expenses without government grants. Universities lobby actively for government funding.").

208. ASS'N OF AM. UNIVS., MYTHS ABOUT COLLEGE AND UNIVERSITY ENDOWMENTS 2 (2009), *available at* http://www.aau.edu/WorkArea/DownloadAsset.aspx?id=7792.

209. *See, e.g.*, NAT'L CTR. FOR PUB. POL'Y AND HIGHER EDUC., RESPONDING TO THE CRISIS IN COLLEGE OPPORTUNITY 2 (2004) [hereinafter CRISIS IN COLLEGE OPPORTUNITY], *available at* http://www.highereducation.org/reports/crisis/crisis.pdf ("[S]tate leaders must invest significant time and attention to plan for the future of higher education opportunity. No other entity—not the colleges and universities, not the students and the families—can effectively address these issues without the sustained attention of governors and legislators."); NAT'L CONFERENCE OF STATE LEGISLATURES, TRANSFORMING HIGHER EDUCATION: NATIONAL IMPERATIVE—STATE RESPONSIBILITY 4 (2006), *available at* http://mlis.state.md.us/other/Funding_Higher_Ed/2007 July9_NCSL.pdf ("[L]egislators have played a role in creating the crisis in higher education. Specifically, legislators have not made strategic budget and appropriations decisions, have not set clear statewide goals for higher education, and have not exerted strong leadership on higher education issues.").

210. *See* Kevin Kiley, *College Presidents' Paychecks Raise Brows*, USATODAY.COM (Jul. 19, 2011, 2:29 PM), http://www.usatoday.com/news/education/2011-07-19-college-president-pay-increase_n.htm (describing several examples of controversial compensation decisions).

When University of California regents blamed a $1,818 per-student tuition increase on state funding cuts in 2011, for example, opponents criticized the regents for handing out massive pay raises to several university executives, including a $195,000 raise to an employee of UC San Francisco's medical center.[211] A similar controversy surrounded tuition hikes within the California State University system, which elected to pay one of its new university presidents $100,000 more per year than his predecessor.[212] As one state legislator commented, "[f]or those of us who fight for every nickel to help our kids, [the universities] make it very difficult."[213] If schools faced the threat of an endowment tax, legislators and trustees may be more willing to compromise—and ultimately benefit students in the process.

In any case, because the tax is triggered only by endowment growth, universities suffering from state funding cuts would generally not be at risk of paying it. Government support for higher education traditionally fluctuates in "'boom and bust' cycles" that coincide with changes in the overall economy.[214] Thus, legislatures are most likely to cut funding during periods when endowments are least likely to grow. In the rare instance that this is not the case, it seems hypocritical for schools to accumulate endowment income while simultaneously blaming tuition increases on the loss of state support. In fact, in such cases, an endowment tax could be useful in discouraging colleges and universities from using legislative decisions as an excuse to shift the burden of profligate spending onto students.

V. CONCLUSION

The controversy surrounding the steadily increasing price tag of higher education has intensified in recent years, as universities' wealth has ballooned to record proportions. Commentators have suggested numerous proposals for legislative reform, all designed to encourage schools to spend more of their endowment income on current students. Unfortunately, most of these proposals would do little to increase educational access for students, and in the worst cases, they could

211. Larry Gordon, *Regents Approve UC Tuition Hike*, LATIMES.COM (Jul. 15, 2011), http://articles.latimes.com/2011/jul/15/local/la-me-uc-tuition-20110715.

212. Carla Rivera, *Salary Plan for San Diego State President Stirs Furor*, LATIMES.COM (Jul. 9, 2011), http://articles.latimes.com/2011/jul/09/local/la-me-calstate-salary-20110709.

213. *Id.*

214. CRISIS IN COLLEGE OPPORTUNITY, *supra* note 209, at 2.

actually foster wasteful spending.

Legislation in this area must walk a fine line, discouraging practices that make college less affordable but supporting endowment building activities that are consistent with the principles of intergenerational equity. Unlike other proposals, linking an endowment tax to tuition lives up to this ideal; while encouraging universities to use more of their wealth to increase educational access, the tax would still leave room for significant endowment accumulation.

Ultimately, a single endowment tax cannot solve the complicated issue of higher-education affordability. That does not mean, however, that Congress should exclude it as a potential option. Although the tax discussed in this Comment would likely attract opposition from colleges and universities, the unique advantages it offers make it worthy of additional consideration.

Matt Willie[*]

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