Rich Schools, Poor Students: Tapping Large University Endowments to Improve Student Outcomes

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Jorge Klor de Alva
President, Nexus Research and Policy Center
www.nexusresearch.org

Mark Schneider
Vice President, AIR
President, College Measures

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About the Authors

Jorge Klor de Alva (jorge.klordealva@nexusresearch.org) is president of the Nexus Research and Policy Center, former president of the University of Phoenix, and former Class of 1940 Professor at the University of California–Berkeley.

NEXUS
Research & Policy Center

Exploring the Frontiers of Higher Education

3701 Sacramento Street, Unit 297
San Francisco, CA 94118
Mobile: 602.684.5401
www.nexusresearch.org

Mark Schneider (mschneider@air.org) is president of College Measures, a vice president at the American Institutes for Research, and former U.S. Commissioner of Education Statistics for the National Center for Education Statistics.

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Executive Summary

On January 8, 2015, President Obama initiated a nationwide conversation about community colleges and the education of the "middle class" by proposing a tuition-free community college plan. Although it has received far less attention, the President's plan also called for effective support services that can help students stay in college long enough to advance their career goals by completing degrees or certificates and/or transferring to four-year institutions. Rather than free tuition, which already exists for most students who need it, this study maintains instead that proven student support services are what need to be funded.

To pay for such services, we lay out a potentially bipartisan strategy to create a funding stream—one resulting from Congress revisiting the current exemptions from taxation enjoyed by the large endowments held by a small number of very wealthy private, not-for-profit institutions.

By comparing the level of tax exemptions and appropriations received per student in high- and moderately endowed institutions, along with the amount public flagship, regional, and community colleges receive, this study demonstrates the extent to which private universities are not necessarily private.

In fact, many of the richest universities in the country--sitting on hundreds of millions, if not billions, of dollars in tax exempt endowments, and garnering tens of millions of dollars of tax deductible gifts every year--receive government subsidies through current tax laws that dwarf anything received by public colleges and universities, institutions that educate the majority of the nation's low- and middle-class students. For example, we estimate that in 2013, Princeton University's tax-exempt status generated more than $100,000 per full-time equivalent student in taxpayer subsidies, compared to around $12,000 per student at Rutgers University (the state flagship), $4,700 per student at the nearby regional Montclair State University, and only $2,400 per student at Essex Community College.

Because affluent schools educate a far lower percentage of low- and middle-income students than public institutions or private not-for-profit institutions with smaller endowments, the distribution of subsidies is inversely related to the distribution of low-income and middle-class students. Indeed, in many cases average taxpayers are subsidizing the education of students in the well-endowed and more selective schools to a far greater extent than they are supporting the education of their own children, most of whom attend broad-access public institutions. *In other words, the majority of taxpayers are poorly served by the tax-exempt status of large college endowments. And providing a public benefit is the purpose of granting tax-exempt status to private not-for-profit institutions.*

While this study recognizes that these large endowments are of benefit to the faculties and students of the rich institutions and to those who can take advantage of the cultural events and facilities the schools sponsor, this does not mean that the status quo is acceptable.

Although it is perhaps unfair to suggest that Harvard is only "a hedge fund with an educational institution attached," it is only fair that Harvard and its wealthy peers step up and pay back a part of what the nation's taxpayers have granted them through tax exemptions. The nation's need for adequately educated students cannot be met without significant additional financial support, and a fair source for that support is a reallocation to underfunded public institutions of a percentage of the tax-exempt subsidy that the nation's taxpayers provide America's wealthiest colleges and universities.

Given the Administration's tuition-free community college proposal, the pending renewal of the Higher Education Act, and the recent report on the dramatic growth of college endowments in 2014, the time is right for an inquiry into the tax status of endowments.

To that effect, this study proposes a sliding scale excise tax on endowments of more than $500 million held by private universities. The proposed tax rate (0.5 to 2.0 percent) aligns with the range of tax rates to which private foundations are already subject.

To help minimize the impact of these assessments on the 95 institutions that in 2014 would have been subject to the tax, we recommend first that tax deductions for gifts given to these colleges remain in place. Second, to ensure that the proposed tax does not reduce the financial aid already awarded by campuses and to encourage even more institutional aid to low- and middle-income students, we recommend that institutions be allowed to offset their new tax liability annually by the amount the school appropriates for financial aid to Pell-eligible students.

To ensure tax revenue neutrality, we propose that a new charitable tax credit be established that builds on the tax legislation which created several types of tax credit bonds under the Internal Revenue Code. As was the case with previous qualified tax credit bonds administered by the U.S. Department of the Treasury (Treasury) and used to support a variety of educational and energy initiatives, these charitable tax credits can provide an attractive opportunity for corporations or others seeking to reduce their tax burden in a socially responsible manner.

In effect, the proposed tax credits build on past procedures to support the implementation of practices that have proven to benefit community college students. The following outlines an implementation strategy:

First, Treasury would estimate the annual yield of the excise tax on endowments over $500 million.

Second, Treasury would fix the amount to be offset through the tax credits to equal that yield.

Third, the U.S. Department of Education (ED) would establish a panel of experts to determine the qualifying criteria and evaluate proposals from community colleges. ED would then issue a request for proposal (RFP) from community colleges. The RFP would specify that only activities with evidence that they are associated with student success—measured by indicators such as increased student progression, retention, completion, or job placement—would qualify for financial support.

Fourth, interested community colleges would help to identify taxpayers interested in the tax credits. This effort would help promote links between colleges and corporations that are critical to resolving the current gaps between what is taught and the workplace skills and competencies that industries need.

Periodic evaluation of the program's effectiveness would ensure its continual improvement.

Introduction

On January 8, 2015, President Obama proposed making community colleges tuition-free "for everybody who is willing to work for it."[1] The initiative, officially announced at a Tennessee community college the following day, and passionately articulated during his State of the Union address, set off a nationwide conversation about community colleges and the education of the middle class.[2] While the merits of free community college for all were hotly debated,[3] there was wide consensus that, with an annual price tag of about $6 billion, the plan is not likely to pass this Congress.[4]

We agree this is an important topic for the nation to address, but disagree with those who argue that free tuition at community colleges is what students need most. Instead, given the disappointingly low rates of student success in many community colleges and public regional universities, along with others we believe access without support is not opportunity.[5] What is

1 Hudson, D. (2015). *The President proposes to make community college free for responsible students for 2 years.* Retrieved from https://www.whitehouse.gov/blog/2015/01/08/president-proposes-make-community-college-free-responsible-students-2-years

2 On the Obama administration's use of "middle class," see: Zumbrun, J. (2015, January 20). What is the middle class, anyway? A look at Obama's focus on 'middle-class economics.' *The Wall Street Journal.* Retrieved from http://blogs.wsj.com/economics/2015/01/20/who-is-the-middle-class-anyway-a-look-at-obamas-focus-on-middle-class-economics/?mod=WSJ_hpp_LEFTTopStories

3 For a compilation of positions on the idea of free community college, see: Inside Higher Ed. (2015). *The debate on free tuition at community colleges booklet.* Retrieved from https://www.insidehighered.com/download/form.php?booklet=FTD; Button, K. (2015). *Five pros and cons of Obama's free community college plan.* Retrieved from http://www.educationdive.com/news/5-pros-and-cons-of-obamas-free-community-college-plan/356289/ and Leef, G. (2015). *Two economists try teaching Obama a logic lesson about "free" community college.* Retrieved from http://seethruedu.com/two-economists-try-teaching-obama-a-logic-lesson-about-free-community-college/

4 Allen, J., Lauerman, J., & Lorin, J. (2015, January 8). Obama proposes free community college. *Bloomberg.* Retrieved from http://www.bloomberg.com/news/2015-01-09/obama-proposes-making-community-college-free-for-many-students.html

5 Engstrom, C., & Tinto, V. (2008). Access without support is not opportunity. *Change Magazine.* January/February. Retrieved from http://www.changemag.org/Archives/Back%20Issues/January-February%20 2008/abstract-access-without-support.html; Brooks, D. (2015, January 19). Support our students. *The New York Times.* Retrieved from http://www.nytimes.com/2015/01/20/opinion/david-brooks-support-our-students.html?emc=edit_ty_20150120&nl=opinion&nlid=49573421&_r=1; and Porter, E. (2015, February 17). The promise and failure of community colleges. *The New York Times.* Retrieved from http://www.nytimes.com/2015/02/18/business/economy/the-promise-and-failure-of-community-colleges.html?ref=education&_r=2. A recent MDRC study of the Accelerated Study in Associate Programs (ASAP) of community colleges in New York showed how integrated, comprehensive interventions, especially including strong advising, can substantially improve outcomes for students; see: MDRC. (2015). *New study shows CUNY's ASAP program nearly doubles three-year graduation rate of community college students who need remedial education.* Retrieved from http://www.mdrc.org/news/press-release/new-study-shows-cuny-s-asap-program-nearly-doubles-three-year-graduation-rate

most needed is adequate funding for effective support services and student retention programs that can help students stay in college long enough to be prepared to join the workforce or to advance their career goals by completing degrees or certificates and/or transferring to four-year institutions.

The Aim of This Study

First, we hope to help move the President's proposal away from funding free community college tuition, a reform of uncertain value, to funding student support services and retention programs at broad-access community colleges and public regional universities, an initiative that could more effectively improve the opportunities of low- and middle-income students. Second, we propose that, rather than funding these initiatives through new taxes on wealthy *individuals,* a strategy unlikely to be supported by Republicans or upper-income Democrats,[6] a far less contentious funding stream could result from Congress revisiting the current exemptions from taxation enjoyed by the large endowments held by a small number of very wealthy private, not-for-profit *institutions*.

With that in mind, we begin this study by exploring the assumption that these large endowments are wholly beneficial to the general public—the very justification for tax-exempt status. In particular, this study demonstrates the extent to which well-endowed private institutions, on a per-student basis, are being subsidized by taxpayers at far greater rates than are students at the public two- and four-year schools responsible for educating the majority of working- and middle-class Americans. This unequal and hidden subsidy is a component of what Suzanne Mettler has called "the submerged state," a vast array of costly government programs buried in tax codes. While these programs are all too often hidden from public view, they are nonetheless real and expensive.[7]

The Hidden Public Cost of "Private" Nonprofit Colleges

In our nation's system of postsecondary education, taxpayer support is often distributed in such a way that, on a per-student basis, upper-income students often receive far larger subsidies than their low-income counterparts.[8] At first glance, this seems unlikely because many low-income students attend public institutions supported by state and local appropriations. In contrast, students who attend private not-for-profit colleges and universities, while on average coming from wealthier families, receive far lower—and often no—*direct* government subsidies. However, as we detail in this study, these private institutions are tax exempt and the per-student value of that tax exemption can far surpass the level of direct government subsidies.[9]

To make sense of how per-student subsidies are higher at schools serving wealthier students, we first need to grasp the extent to which governments at all levels invest in postsecondary education. In 2014, the

6 Baker, P. (2015, January 20). Bold call to action in Obama's State of the Union, even if no action is likely. *The New York Times.* Retrieved from http://www.nytimes.com/2015/01/21/us/politics/state-of-the-union-speech-leaves-questions-about-usefulness-of-unlikely-goals.html?ref=politics; Edsall, T. B. (2015, February 4). The problem with middle-class populism. *The New York Times.* Retrieved from http://www.nytimes.com/2015/02/04/opinion/the-problem-with-middle-class-populism.html?emc=edit_ty_20150204&nl=opinion&nlid=49573421; and Field, K. (2015, January 29). On 529 plans, Obama is reminded, don't mess with the 'middle class.' *The Chronicle of Higher Education.* Retrieved from http://chronicle.com/article/On-529-Plans-Obama-Is/151469/?cid=at&utm_source=at&utm_medium=en

7 Mettler, S. (2011) *The Submerged State*. Chicago: University of Chicago Press.

8 We recognize, of course, that need-based financial aid is based on demonstrated financial need and financial need is defined as the difference between the cost of attendance (COA) and the expected family contribution (EFC). Therefore, there are two main ways of increasing need: have a lower EFC or the student can enroll at a higher-cost college. This is why, for example, wealthier students are more likely to get subsidized Federal Stafford loans at higher-cost, private not-for-profit colleges than at an in-state public college. So, the amount of aid can be expected to increase at higher-cost colleges. However, the exception is the Federal Pell Grant, which is based solely on the EFC, without regard to financial need. Nonetheless, we have not included any of the subsidies through subsidized student loans in our calculations. As is clear below, we are primarily focused on the flow of money to institutions.

9 These tax exemptions are "off budget"—but they translate into taxpayer subsidies that, from a public policy perspective, should be treated as the equivalent of direct appropriations.

federal government[10] spent as much as $30 billion in student grants and another $37 billion in tax credits, deductions, and exemptions, subsidizing the ability of individuals and families to pay for higher education. In addition, the federal government issued close to $100 billion in student loans, a quarter of which were subsidized to help students meet the costs of their education. Even in this period of reduced state support, states and local governments also contribute substantial subsidies to higher education. According to a report by the State Higher Education Executive Officers (SHEEO), in 2013 state and local governments spent more than $80 billion supporting colleges and universities.[11]

Appropriations for the operating and capital expenditures of postsecondary institutions are part of a budgetary process in which legislators and elected officials consider the fiscal health of their jurisdictions and balance competing constituency demands on their treasury. And most of the billions of tax dollars appropriated for higher education go to state universities and community colleges, many of which open their doors widely to low-income, first generation, and racial/ethnic minority students.

In contrast, far less visible is the extent to which taxpayers support private, not-for-profit colleges and universities.[12] For these schools, taxpayer subsidies at the institutional level flow mostly from their being exempt from local, state, and federal taxes, including property taxes, and from the donations made to their endowments. Their investment income, generated from endowments or other initiatives, is also not taxed as are investment earnings at a private company. But unlike appropriations, these tax expenditures are rarely itemized and tabulated. Additionally, people who make donations can deduct their gifts from their taxes, which is an incentive to make the gifts in the first place.

These tax subsidies, being mostly invisible, are rarely the subject of political discussion.[13] Given the nature of the U.S. tax system, the bigger the gifts to a private not-for-profit institution, the greater their investment income is likely to be. Besides the tax exemption on income, not-for-profit colleges are also exempt from property taxes.[14] Given the size of some of these tax exemptions, a significant part of the education of students attending the best-endowed private colleges is supported by federal, state, and local taxpayer subsidies that can dwarf the total per-student allocations that governments appropriate to public colleges.

Because affluent schools educate a far lower percentage of low- and middle-income students than public institutions or private not-for-profit institutions with

10 New America Foundation. (2014). *Federal Education Budget Project.* Retrieved from http://febp.newamerica.net/background-analysis/federal-higher-education-programs-overview

11 “Of the $81.6 billion in state and local support during 2013, 76.5 percent was allocated to the general operating expenses of public higher education. Special purpose or restricted state appropriations for research, agricultural extension, and medical education accounted for another 12.2 percent of the total. The percent of total support allocated for financial aid to students attending public institutions increased to 7.9 percent in 2013.” State Higher Education Education Officers. (2014) *State higher education finance: FY 2013.* Boulder, CO: SHEEO (p.7). Retrieved from http://www.sheeo.org/sites/default/files/publications/SHEF_FY13_04292014.pdf

12 In this study we are not including federal or state research grants or property tax exemptions in our estimates of subsidies to colleges and universities, both of which would drive up even further our estimates of the amount of per-student subsidy to private not-for-profit institutions.

13 However, large endowments, those over $500 million, emerged as an item of interest to the Senate Finance Committee in 2008. The United States Senate Committee on Finance. (2008). *Grassley urges continued look at college endowment growth, student affordability.* Retrieved from http://www.finance.senate.gov/newsroom/ranking/release/?id=38a762b5-0fc7-4a9c-a130-3ddf23812279; Arenson, K. W. (2008, January 25). Senate looking at endowments as tuition rises. *The New York Times.* Retrieved from http://www.nytimes.com/2008/01/25/education/25endowments.html?_r=0. Some municipalities are beginning to publicly explore estimating the foregone property tax revenue of nonprofits, including colleges and universities; see: Povich, E. S. (2015). Should nonprofits have to pay taxes? Retrieved from http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2015/3/05/should-nonprofits-have-to-pay-taxes

14 See, for example, Humphreys, J., & Solomon, A. (2012). *Public investment in private higher education: Estimating the value of nonprofit college and university tax exemptions.* Boston: Tellus Institute. Retrieved from http://tellus.org/publications/files/college-tax-exemption.pdf

smaller endowments,[15] the distribution of subsidies is inversely related to the distribution of low-income and middle-class students. Indeed, as we show below, in many cases *average taxpayers are subsidizing the education of students in the better-endowed and more selective schools to a far greater extent than they are supporting the education of their own children, most of whom attend broad-access public institutions.*[16]

Table 1 demonstrates this last point. The table is based on: (1) the difference between 2013 and 2014 endowment data,[17] used as a proxy for investment gains,[18] (2) the average effective combined state and federal long-term capital gains rates for 2013,[19] and (3) the latest (2012–13) U.S. Department of Education enrollment and government appropriations figures available from the Integrated Postsecondary Education Data System (IPEDS).[20]

Using calculations based on these sources, Table 1 shows the estimated average government subsidy—through direct appropriations and tax exemptions[21]—per full-time equivalent (FTE) graduate and undergraduate student (unless otherwise specified, throughout this study the term "student" refers to "FTE student"), for students attending 10 of the schools with the highest endowments and the corresponding government investment in students attending 10 schools in each of the following categories: Private not-for-profit institutions with moderate endowments (average $15 million), those with low endowments (average $2 million), state flagships, regional campuses, and community colleges—all located in the same state in which the elite private campuses are located.[22]

Table 1 clearly shows how unequal the taxpayer subsidy is distributed. Based on the tax exemptions and appropriations received, we calculate that across the 10 highest endowment private institutions, using a weighted average of enrollments, taxpayers in 2013 spent more than $41,000 per student, *nearly three times the average direct taxpayer subsidies to students attending public flagship campuses in the same state as the private institutions. In effect, the highest-endowment colleges and universities, which need government subsidies the least, get the greatest subsidy per student.*

Table 1 also shows that, on average, states invest more money in their flagships than in their regional campuses and community colleges; the level of

15 According to the calculations of Mark Kantrowitz (personal communication), the percentages of low-income students (Adjusted Gross Income [AGI] < $50,000) by selectivity using the 2011–12 National Postsecondary Student Aid Study (NPSAS): very selective, 41.5%; moderately selective, 51.8%; minimally selective, 59.2%; open admission, 70.5%; for-profit four-year, 74.2%. See also Institute for Women's Policy Research (IWPR) analysis of U.S. Department of Education, National Center for Education Statistics, 2007–08 and 2011–12 (NPSAS:08 and NPSAS:12) presented in: Gault, B., Reichlin, L., & Román, S. (2014). *College affordability for low-income adults: Improving returns on investment for families and society.* Washington, DC: IWPR. Retrieved from http://www.iwpr.org/publications/pubs/college-affordability-for-low-income-adults-improving-returns-on-investment-for-families-and-society/. On the need for students to work, see: Scott-Clayton, J. (2012) *What explains trends in labor supply among U.S. undergraduates, 1970–2009?* Cambridge, MA: National Bureau of Economic Research. Retrieved from http://www.nber.org/papers/w17744.pdf

16 See Klor de Alva, J., & Schneider, M. (2011). *Who wins? Who pays? The economic returns and costs of a bachelor's degree.* San Francisco: Nexus Research and Policy Center; Washington, DC: American Institutes for Research; p. 14. Retrieved from http://www.air.org/sites/default/files/downloads/report/WhoWins_bookmarked_050411_0.pdf; Schneider, M., & Klor de Alva, J. (2011). *Cheap for whom? How much higher education costs taxpayers. Washington, D.C.: American Enterprise Institute.* Retrieved from http://www.aei.org/wp-content/uploads/2011/10/08-EduO-Schneider-Oct-2011-gnew.pdf

17 NACUBO. (2015). *U.S. and Canadian institutions listed by Fiscal Year (FY) 2014 endowment market value and change in endowment market value from FY2013 to FY2014.* Retrieved from http://www.nacubo.org/Documents/EndowmentFiles/2014_Endowment_Market_Values_Revised.pdf

18 Because the IPEDS data on income (for schools that use Government Accounting Standards Board [GASB]) and investment return (for schools using Financial Accounting Standards Board [FASB]) do not distinguish recognized as opposed to unrecognized gains from investments, we searched for the best proxy possible for realized gains. After substantial consultation, we settled on the delta between annual endowment results. We recognize this solution is not perfect, but other alternatives we explored—in the absence of the relevant data—were found to be too speculative for this study. *This is why one of our recommendations is greater transparency in reporting of endowment returns.*

19 See Table 1 in: Tax Foundation. (2013). *The high burden of state and federal capital gains taxes.* Retrieved from http://taxfoundation.org/article/high-burden-state-and-federal-capital-gains-taxes

20 National Center for Education Statistics. (n.d.). *IPEDS Data Center.* Retrieved from http://nces.ed.gov/ipeds/datacenter/

21 Note that property tax exemptions, discussed below, are not included in our sum of taxpayer subsidies.

22 For details on methods and calculations, see Appendix A.

Table 1: Total Federal, State, and Local Appropriations and Tax Subsidies* Per FTE Student, Endowment Size,** and Institution Type

State	Private – High Endowment	Private – Midlevel Endowment	Private – Low Endowment	Public Flagship	Public Regional	Community College
CA	Stanford University	Biola University	Holy Names University	University of California, Berkeley	California State University, Fullerton	Fullerton College
	$63,100	$1,300	$700	$10,500	$4,000	$8,100
CT	Yale University	Connecticut College	University of St. Joseph	University of Connecticut	Central Connecticut State University	Tunxis Community College
	$69,000	$5,700	$900	$23,300	$6,700	$6,200
IL	University of Chicago	North Central College	Olivet Nazarene University	University of Illinois, Urbana-Champaign	Western Illinois University	Waubonsee Community College
	$19,300	$1,200	$300	$7,500	$12,600	$8,000
IN	Notre Dame University	Indiana Wesleyan University	St. Mary-of-the-Woods College	Indiana University, Bloomington	Indiana State University, Terre Haute	Ivy Tech Community College
	$26,900	$600	$400	$7,000	$7,200	$3,100
MA	Harvard University	Bentley University	Labouré College	University of Massachusetts, Amherst	Bridgewater State University	Massasoit Community College
	$48,000	$2,200	$200	$9,900	$4,600	$4,100
NC	Duke University	Guilford College	High Point University	University of North Carolina, Chapel Hill	University of North Carolina, Charlotte	Central Piedmont Community College
	$13,400	$1,000	$400	$24,400	$8,800	$5,100
NJ	Princeton University	Rider University	Centenary College	Rutgers University	Montclair State University	Essex County College
	$105,000	$500	$900	$12,300	$4,700	$2,400
NY	Columbia University	Alfred University	Keuka College	Stony Brook University	City University of New York, Queens College	Queensborough Community College
	$14,500	$2,000	$300	$16,800	$5,300	$5,300
PA	University of Pennsylvania	Robert Morris University	Keystone College	Pennsylvania State University, University Park	Indiana University of Pennsylvania, Main Campus	Westmoreland County Community College
	$27,000	$300	$100	$9,000	$8,400	$2,700
TX	Rice University	University of the Incarnate Word	Texas College	University of Texas, Austin	Texas State University, San Marcos	Austin Community College, San Marcos
	$24,500	$400	$100	$32,500	$4,400	$6,400
Average	**$41,100**	**$1,500**	**$400**	**$15,300**	**$6,700**	**$5,100**

* Does not include subsidies based on property tax exemptions.

**Based on 2013 endowments: High endowments (HE) average, $1,570,000,000; medium endowments (ME), $15,000,000; low endowments (LE), $2,000,000.

per-student support given to the 10 regional campuses in our study is about 44 percent of what is given to students attending flagships. And while nearly half of students beginning their postsecondary education attend community colleges,[23] taxpayers support these students at the lowest levels, *with each student receiving*

23 Community College Research Center. (n.d.). *Community college FAQs*. Retrieved from http://ccrc.tc.columbia.edu/Community-College-FAQs.html. The support per student is lowest at community colleges for several reasons, including lower tuitions and degree attainment rates, and the shorter length of many of their educational programs.

only about one dollar for the nearly eight dollars that taxpayers send per student to the elite private schools in our study.

To see the extent of this inequality, consider the case of California.[24] In this study, we compare the measurable taxpayer subsidy per student at Stanford University (one of the private institutions with the largest endowment in the nation), the University of California–Berkeley (one of California's flagship campuses), California State University–Fullerton (the largest regional campus in the state categorized as "Competitive" in *Barron's Profiles of American Colleges 2013*[25]), and Fullerton College (a community college near CSU–Fullerton with approximately 25,000 students). In 2013, Stanford received more than $63,000 in taxpayer support per student as compared to UC–Berkeley's per student's approximately $10,000, CSU–Fullerton's per student $4,000 and Fullerton College's per student's $8,000. (Community colleges in California have very low tuitions so the state and local appropriations are high compared with community colleges in most other states.)

Consider next Princeton University. With a large wealthy donor base and small enrollment,[26] Princeton is a clear leader in garnering taxpayer subsidies per student. Indeed, in 2013 Princeton received $105,000 in national, state, and local taxpayer support—through direct government appropriations but far more through tax exemptions—for each student.[27] Highly selective tax-exempt institutions such as Stanford, Harvard and Yale had lower taxpayer subsidies per student, but theirs were still quite hefty at more than $48,000.

24 In Appendix B, Table B.1, we list the full names of each institution in this study and describe how they were chosen.

25 Barron's Educational Series, Inc. (2013). *Barron's profiles of American colleges 2013*. Hauppauge, NY. Retrieved from http://www.barronspac.com/

26 See Appendix B, Table B.3 for FTE student enrollment and total number of students in each of the 60 schools in our sample.

27 This amount does not include either federal research money or property tax exemptions. Richard Vedder has also calculated significant tax subsidies for Princeton, using somewhat different assumptions and numbers based on 2010 data (when endowments were still reeling from the 2008 recession). Vedder, R. K. (2012, March 18). Princeton reaps tax breaks as state colleges beg. *Bloomberg Review*. Retrieved from http://www.bloombergview.com/articles/2012-03-18/princeton-reaps-tax-breaks-as-state-colleges-beg

These taxpayer subsidies dwarf the per-student state appropriations to the public flagship campuses located in the same states as our set of well-endowed private schools. For example, for every dollar a student attending Rutgers University received in direct appropriations, taxpayers were providing more than $8.5 dollars of tax revenue as an indirect subsidy per student at Princeton. Similarly, Stanford received a level of taxpayer support per student that was nearly six times greater than the level of state and local taxpayer support enjoyed per student at UC–Berkeley. The per-student appropriations for students at the University of Connecticut were among the highest among these 10 flagships, but on average, even that level of state and local taxpayer support was still only a third of the per student taxpayer subsidy at Yale. Whether the subsidies support faculty research or the education of students, and whether the charitable donations are restricted or unrestricted, these enormous taxpayer subsidies amount to welfare for the wealthy.

Among the wealthiest universities on our list, only three—Duke, Columbia, and Rice—had taxpayer subsidies lower than the comparison flagships. Yet the elite private campuses and state flagships share many characteristics—they are all research institutions with significant (and costly) graduate programs. In these "apple-to-apple" comparisons, in most cases the taxpayer is sending more (sometimes far more) money to the private campus than to the, on average, much larger and more ethnically and economically diverse public one. In effect, the appropriations public institutions receive come from and are dependent on the vagaries of the more limited state and local tax base, while federal and state tax laws favor our set of private colleges—and these tax subsidies are not subject to the same annual budget scrutiny as direct government appropriations.

As Table 1 also demonstrates, when we compare the differences in subsidies received by the wealthy privates to those going to less wealthy private universities, regional institutions, and community colleges, we find even greater disparities. As noted, taxpayers contributed more than $105,000 per Princeton student. In contrast, students at the far larger Montclair State College or Essex County community college each received less than 5 percent of the Princeton per student subsidy. Taxpayers provided approximately $10 per each Harvard student for every dollar state and local taxpayers provided to students at Bridgewater State College or Massasoit Community College. In North Carolina, the per-student support at UNC–Charlotte was about 34 percent less than the per-student taxpayer support at Duke, and at Central Piedmont Community College students received only about $1 for every $2.60 that taxpayers spent per student at Duke. And as is commonly known, students at these regional campuses and community colleges are far more likely to come from low-income and middle-class families than students at Princeton, Harvard, or Duke. And as is also well known, disparities in funding contribute to disparities in student outcomes.[28]

Finally, when we compare taxpayer subsidies per student across the 10 private institutions in each of the three endowment levels in Table 1 the differences are staggering. For instance, in 2013 the per-student taxpayer subsidy at Robert Morris University in Pennsylvania (with a medium-sized endowment) was only 1 percent of what the per-student subsidy was at the University of Pennsylvania, and it was less than 0.5 percent of that at the state's low-endowment Keystone College.

28 See, for example, the research of James J. Heckman and others, including: Heckman, J., & Krueger, A. (Eds.). (2003). *Inequality in America: What role for human capital policy?* J. Cambridge, MA: MIT Press.

Property Tax Exemptions Produce Even More Taxpayer Subsidies for Wealthy Schools

Private colleges are also exempt from paying property taxes, which adds, sometimes substantially, to the level of taxpayer subsidy.[29]

Despite the high value of property owned by many colleges, we could not include property tax exemptions in our study because it is difficult to get data about their value, and in many cases even the institutions themselves may not know the assessed value of their properties. After all, if property is not taxed, it is unlikely to be assessed by local governments or the institutions themselves. But as we note below, there is evidence that many of these institutions are sitting on extremely valuable tax-exempt property. Much of this evidence comes about because some universities voluntarily make payments in lieu of taxes (commonly referred to as "PILOTs") and some municipalities have tried to negotiate with schools for such payments. But, again, systematic data on the size of these voluntary payments are incomplete, nonexistent, or generally unavailable to researchers.[30]

Nonetheless, scattered evidence suggests the size of these tax breaks. Consider Stanford University. According to the Santa Clara County Assessor,[31] in 2013 Stanford University (and its hospitals) had one

29 There are other avenues for tax subsidies we have not measured, including exemption from state income and excise taxes, state and local sales tax, and tax-exempt bonds. Researchers at the Tellus Institute have proposed a broad framework for identifying and classifying all these expenditures, but we have chosen a more limited exercise across a wider range of schools. See: Tellus Institute. (2012). *Public investment in private higher education: Estimating the value of nonprofit college and university tax exemptions.* Retrieved from http://tellus.org/publications/files/college-tax-exemption.pdf. Also see Povich, E. S. (2015). *Should nonprofits have to pay taxes?* Retrieved from http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2015/3/05/should-nonprofits-have-to-pay-taxes

30 Humphreys, J., & Solomon, A. (2012). *Public investment in private higher education: Estimating the value of nonprofit college and university tax exemptions.* Boston: Tellus Institute; p.2. Retrieved from http://tellus.org/publications/files/college-tax-exemption.pdf

31 San Jose: Santa Clara County Office of the County Assessor. 2013–2014 *Assessor's Annual Report.* Retrieved from https://www.sccassessor.org/DocLib/Annual%20Report13.pdf

of the largest exemptions in the state of California, receiving an exemption from their assessed value of close to $8 billion, or more than $555,000 per student. In 1978, voters approved Proposition 13, which placed strict limits on property taxes throughout California, setting a 1 percent property tax rate but giving communities some leeway to supplement that tax rate. Since most communities in Santa Clara County have tax rates closer to 1.1 percent, this produces yet another $6,000 taxpayer subsidy per Stanford student, which alone is 50 percent higher than per-student subsidies at the CSU Fullerton campus.

Researchers at the Lincoln Institute of Land Policy have conducted a detailed investigation of PILOTs.[32] In their study, Daphne Kenyon and Adam Langley note that in 2009 Harvard had almost $1.5 billion in property in Boston proper, on which it would have had to pay $40 million in property tax for the year, had they not been exempt. Harvard did make a PILOT payment of almost $2 million, garnering $38 million in net tax breaks.[33] Consequently, in 2009 Harvard received an additional taxpayer subsidy of more than $1,800 per student, generated through property tax exemptions in the city of Boston alone.[34]

Another Aspect to Growing Inequality: The Size of Endowments and Pell Participation Rates

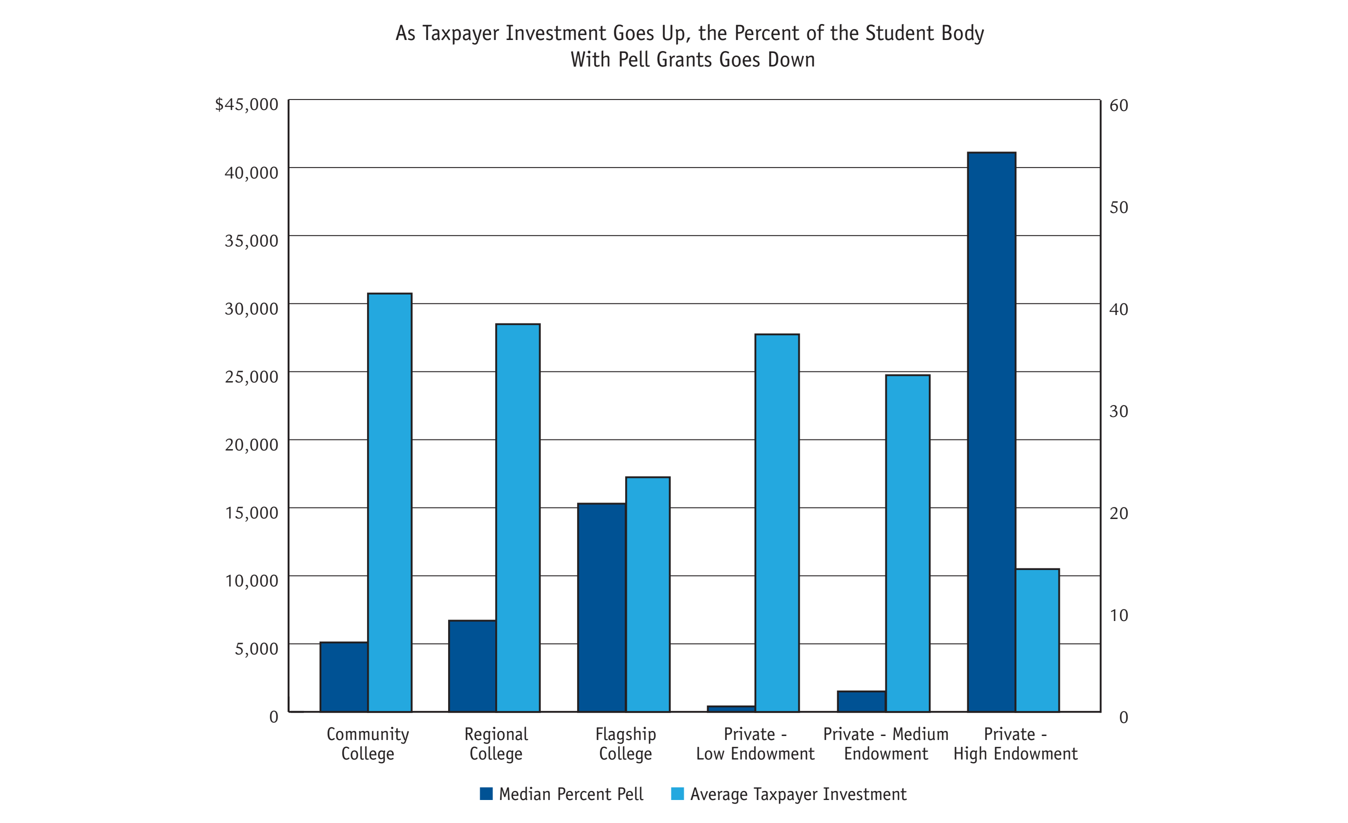
Figure 1 presents an unfortunate fact: As the concentration of low-income Federal Pell grant recipients increases, the average taxpayer subsidy decreases. As shown in detail in Appendix B, Table B.2, only 14 percent of students in our sample of 10 elite private institutions have Federal Pell grants, while 41 percent of the students in the 10 community colleges and 38 percent in the 10 regional campuses in this study have incomes low enough to qualify for Federal Pell grants. Likewise, at the private colleges across those with medium-size endowments and average taxpayer subsidies of only $1,500, the percentage of students receiving Pell grants goes up to approximately 33 percent, and the percentage of Federal Pell grant recipients goes even higher, to 37 percent, in the 10 private schools which, with the smallest endowments, receive on average approximately $400 per student in taxpayer subsidies.

32 Kenyon, D. A., & Langley, A. H. (2010). *Payments in lieu of taxes: Balancing municipal and nonprofit interests.* Cambridge, MA: Lincoln Institute of Land Policy. Retrieved from http://www.lincolninst.edu/subcenters/significant-features-property-tax/upload/sources/ContentPages/documents/PILOTs%20PFR%20final.pdf

33 Harvard's five cents on the dollar PILOT payment was about in the middle of all the Boston campuses on which the researchers at the Lincoln Institute reported detailed information. Boston University, which in Boston had even more in property than Harvard, paid 8.5 percent of its "normal" tax bill (close to $5 million), while Northeastern University paid only $30,000 as its PILOT, representing less than one percent of the taxes it would have had to pay had it not had tax-exempt status.

34 This estimated subsidy would be substantially higher if the property exemption on Harvard's more extensive properties in Cambridge were also included.

Figure 1: Median Percentage of Federal Pell Grant Participation Versus Average Taxpayer Subsidy by Type of Institution, 2013



In short, the unequal distribution of endowment wealth and the unequal enrollment of low-income Federal Pell grant recipients lead to a pattern where, quite literally, the rich schools get more than their less affluent private and public counterparts, who are bearing the lion's share of the education of America's working- and middle-class students.

Will Free Tuition in Community Colleges Lead to Student Success?

As Figure 1 and Appendix B, Table B.2 show, on average, community colleges serve a higher percentage of Federal Pell grant recipients than do private and public four-year institutions. Being the gateway to postsecondary education for a high percentage of the nation's low-income, at-risk students,[35] community colleges need all the help they can get. However, the tuition-free community college plan proposed by President Obama, though recognizing the need for well-funded and proven student services, focuses on increasing access, under the assumption that many potential and current students are not enrolling or continuing their education because

35 Peak, C. (2015). *Seven reasons why community colleges are necessary for America's prosperity.* Retrieved from http://nationswell.com/community-colleges-are-key-to-americas-success/ and American Association of Community Colleges. (2015). *2015 fact sheet.* Retrieved from http://www.aacc.nche.edu/AboutCC/Documents/FactSheet2015.pdf

they lack financial resources. But, for several reasons, it is not obvious that additional financial aid is what most of these students need to complete their studies.

First, community colleges are already relatively affordable. Their average annual tuition is just over $3,000,[36] and more than 70 percent of students pay less than $1,000 per year in tuition. Overall, about 40 percent of students already attend tuition-free.[37]

Additionally, the gap in the rates at which poor and rich prospective and actual students succeed in postsecondary education is vast and will not be bridged by free community college tuition. As one researcher recently concluded, "For the richest quartile, enrolling in college makes graduation a virtual certainty. For everyone else, it's at best a coin flip. More than half of students from the lower half of the income distribution [who started college] aren't finishing college.... *This is why getting more students in the door through free tuition won't be enough."*[38]

In general, it is widely accepted, even by those supporting the President's plan, that completion rates will not likely improve simply by increasing access through tuition-free community colleges. Rather, expanding access to community college (and even four-year regional campuses) in the absence of proven student support services and carefully defined performance measures will likely mean increasing the number of students who have tried and failed to attain postsecondary credentials.[39]

Rather than directing money at reducing already low community college tuitions, Congress should focus on funding student support services that have been found to be effective, such as those identified by Thomas Bailey and other researchers at Columbia University's Community College Research Center[40] and recently supported by the MDRC study of community colleges in New York. Indeed, such an effort would build on a component of the Administration's community college plan that has been mostly neglected, having been overshadowed by its call for "free tuition." The President's proposal also highlights other actions associated with increased student completion. An example is the provision requiring students to maintain a 2.5 minimum grade point average and that they make "steady progress" towards completion.[41] Furthermore, although no details were offered, the proposal specifically requires states to have a performance-based plan in place and participating community

36 Bumphus, W. G. (2015). *America's community colleges: the infrastructure of opportunity.* Retrieved from http://www.rollcall.com/news/americas_community_colleges_the_infrastructure_of_opportunity_commentary-239839-1.html?pos=oopih

37 Button, K. (2015). *Five pros and cons of Obama's free community college plan.* Retrieved from http://www.educationdive.com/news/5-pros-and-cons-of-obamas-free-community-college-plan/356289/

38 Nelson, L. (2015, February 4). *The vast income gap in college degrees, in three charts.* Retrieved from http://www.vox.com/2015/2/4/7978481/college-completion-charts Our emphasis.

39 The most recent national data available broken down by income quartiles show that among students in the lowest income quartile who started at a two-year college in 2003–04, only 13 percent completed an associate degree by 2009 and an additional 9.4 percent earned a certificate while 8.3 percent earned a bachelor's degree. Among students in the second-lowest income quartile, the results were only slightly better: 15.8 percent completed an associate degree, an additional 10.5 percent earned a certificate, and 10.8 percent were awarded a bachelor's degree. See: National Center for Education Statistics. (2013). *Digest of education statistics, 2013.* Retrieved from http://nces.ed.gov/programs/digest/d13/tables/dt13_326.40.asp?current=yes. Note: although community college students make up the majority of the cohort, these statistics also include students who attended for-profit colleges, where associate degree and certificate completion rates are slightly higher.

40 See, for instance: Bailey, T., Smith Jaggers, S., & Jenkins, D. (2015). *Redesigning America's community colleges: A clearer path to student success.* Community College Research Center. Retrieved from http://ccrc.tc.columbia.edu/publications/redesigning-americas-community-colleges.html

41 It bears noting that while these requirements may help some students reach the finish line, they also will filter out the students who are least likely to graduate. There is a tension between access and completion, where the quickest route toward greater graduation rates (as opposed to the number of students graduating) involves reducing enrollment by high-risk students.

colleges must "adopt promising and evidence-based institutional reforms to improve student outcomes."[42]

Complementing the practices suggested by community college researchers, David Brooks, in a thoughtful *New York Times* column, identifies some of these successful institutional services.[43] These include sufficient, well-trained guidance counselors and mentors; solutions to the problem of students unprepared for college through alternatives to remediation, which today is widely discredited; and adequate child care for the more than 25 percent of college students nationwide with dependent children. "In short," Brooks notes, "you wouldn't write government checks for tuition. You'd strengthen structures around the schools. You'd focus on the lived environment of actual students and create relationships and cushions to help them thrive."[44]

How Could Needed Educational Services Be Paid For?

The implementation of proven student support services will carry a significant price tag—and in today's political environment, finding a way to meet that cost is essential.

In his fiscal 2016 budget, the President asked Congress to fund the free tuition plan by increasing the taxes of high-net-worth taxpayers. As Republicans have repeatedly made clear, they will not approve such a funding scheme.[45] But there is a more politically palatable and potentially bipartisan source that can be tapped to help improve the broad-access public institutions on which the nation depends for the education of the majority of its populace.

The data in this report make evident two important points about tax-exempt endowments:

- Institutions with very large endowments receive far more taxpayer money per student than do public colleges, including flagship campuses.
- In general, the larger the endowment of a college or university, the smaller the percentage of low-income, Federal Pell grant-eligible students served by the institution.

In other words, the majority of taxpayers are poorly served by the tax exempt status of large college endowments. And providing a public benefit is the purpose of granting tax-exempt status to private not-for-profit institutions.

This is not to imply that these endowments are without benefit to those employed by or attending wealthy institutions. Hefty endowments help support the institution's operations and research agenda, provide financial aid for needy and meritorious students, and make possible the public's access to the cultural events and facilities the school sponsors. And we are aware that many of the publicly held myths about endowments, such as they are "a single fund that a school may spend at its discretion," are simply that—myths.[46] However, this does not mean that the status quo should be accepted. Public broad-access two- and four-year institutions need—as was recently said of

42 Hudson, D. (2015). *The President proposes to make community college free for responsible students for 2 years.* Retrieved from https://www.whitehouse.gov/blog/2015/01/08/president-proposes-make-community-college-free-responsible-students-2-years and The White House Office of the Press Secretary. (2015). *Fact sheet—White House unveils America's college promise proposal: Tuition-free community college for responsible students.* Retrieved from https://www.whitehouse.gov/the-press-office/2015/01/09/fact-sheet-white-house-unveils-america-s-college-promise-proposal-tuitio

43 Brooks, D. (2015, January 19). Support our students. *The New York Times.* Retrieved from http://www.nytimes.com/2015/01/20/opinion/david-brooks-support-our-students.html

44 Porter, E. (2015, February 17). The promise and failure of community college. *The New York Times*. Retrieved from http://www.nytimes.com/2015/02/18/business/economy/the-promise-and-failure-of-community-colleges.html?ref=education&_r=2

45 Shinkle, J. (2015). *Republicans: Obama budget 'laughable'*. Retrieved from http://www.politico.com/story/2015/02/republicans-obama-2015-budget-response-114832.html

46 Association of American Universities. (2009). *Myths about college and university endowments.* Retrieved from https://www.aau.edu/WorkArea/DownloadAsset.aspx?id=7792

LaGuardia Community College—"to get a piece of the billions that donors give to higher education."[47]

But how can this be done?

Make Hidden Subsidies Public

If we are to address how best to more fairly support the education of today's growing numbers of middle-class and low-income students, policymakers and elected officials need to know the extent to which taxpayers are subsidizing—directly and indirectly—the education of students.

The data presented in this study suggest a domain where a bright light needs to be shined. Many of our most well-known private colleges are supported by taxpayers to an extent that is far more generous than the support received by the public colleges and universities that most students attend. Most of this money is hidden in tax policies that allow the richest universities to collect government subsidies that dwarf the state and local appropriations allocated by elected politicians. Rather than leaving tax-based subsidies a part of the "submerged state," we need to bring to the surface data about their size, the composition of their investment gains, and their distribution.

Tax Large Endowments

Calling attention to the size of these endowments and the call to make better public use of the taxpayer subsidies adhering to them is not new. In the recent past, the U.S. Congress investigated the size and use of endowments, and one state—Massachusetts—proposed legislation that would have taxed large endowments.

Congressional discussion on endowments reached new levels in September 2007, just before the Great Recession. The focus, on the part of the ranking Republican, Sen. Charles Grassley of Iowa, was on the fact that many endowments had grown significantly while their payout rates (to support more financial aid and lower tuition) appeared to be feeble in comparison. Sen. Jim Bunning (R-Kentucky) raised the question directly: Why, given the great growth of the endowments, "are we allowing our endowments to remain tax-free?"[48]

Four months later, Senators Max Baucus (D-Montana) and Charles Grassley requested colleges and universities with endowments of more than $500 million to respond to a list of questions regarding their endowments.[49] This line of inquiry, aimed at setting a minimum 5 percent payout requirement for all endowments, created a heated national dialogue on the role of endowments.

Perhaps the clearest manifestation of this debate occurred in 2008 as Massachusetts lawmakers, facing a contracting economy, asked state finance officials to study a plan to impose a 2.5 percent annual assessment on college endowments over $1 billion. Supporters of this legislation, pointing to Harvard's then $34 billion endowment, argued that some institutions were hoarding huge endowments while providing only minimal benefits to the communities they served. Faced with powerful opposition from the wealthy colleges and universities in the state, the Massachusetts endowment tax plan was never adopted, but it has generated much debate.[50]

47 Bellafante, G. (2014, November 14). How can community colleges get a piece of the billions that donors give to higher education? *The New York Times*. Retrieved from http://www.nytimes.com/2014/11/16/nyregion/at-college-where-alumni-pockets-are-shallow-a-struggle-to-raise-money.html?_r=0

48 See, for example: Guess, A. (2007, September 27). Senate scrutiny for endowments. *Inside Higher Ed*. Retrieved from https://www.insidehighered.com/news/2007/09/27/endowments

49 The United States Senate Committee on Finance. (2008). *Baucus, Grassley write to 136 colleges, seek details of endowment pay-outs, student aid*. Retrieved from http://www.finance.senate.gov/newsroom/chairman/release/?id=c7395dba-4033-48bb-b1ee-7b061f2e267e

50 For example: Stein, B. (2008). *Taxing the Harvard endowment*. Retrieved from http://www.felixsalmon.com/2008/05/taxing-the-harvard-endowment/ and Salmon, F. (2008). *Why do universities have tax-exempt endowments*. Retrieved from http://www.felixsalmon.com/2008/05/why-do-universities-have-tax-exempt-endowments/. As recently as 2014, the Massachusetts legislature once again addressed a proposal to impose an excise tax on large college endowments: Boston Bar Association College and University Law Section. (2014). *2014 Legislative year in review*. Retrieved from http://www.bostonbar.org/docs/default-document-library/2014-6-11---higher-ed-2014-legislative-year-in-review.pdf?sfvrsn=2

In his much-referenced 2013 article, "Universities shouldn't be tax exempt,"[51] Felix Salmon, a financial journalist, argues that,

"The dollar value of universities' tax exemptions is enormous — and it almost goes without saying that if we simply abolished those exemptions, and used the proceeds to spend on higher education, we would get vastly more bang for our buck. The overwhelming majority of the tax expenditures go to the richest universities — the ones who need the money the least. Meanwhile, great institutions like the University of California are slowly starved to death: direct fiscal expenditures, it seems, are much, much easier to cut than more-hidden tax expenditures."

Although it is perhaps unfair to suggest, as Salmon does, that Harvard is only "a hedge fund with an educational institution attached,"[52] it is only fair that Harvard and its wealthy peers step up and pay back a part of what the nation's taxpayers have granted them through tax exemptions. The nation's need for adequately educated students cannot be met without significant additional financial support, and a fair source for that support is a reallocation to underfunded public institutions of a percentage of the tax-exempt subsidy that the nation's taxpayers provide America's wealthiest colleges and universities.

Given the Administration's tuition-free community college proposal, the pending renewal of the Higher Education Act, and the most recent report on the dramatic growth of college endowments in 2014,[53] the time is right for an inquiry into the tax status of endowments (for the widespread, positive media response generated by the initial publication of this report, see http://nexusresearch.org/nexus-in-the-news/).

To that effect, some version of the sliding scale assessment on endowments shown in Table 2 is in order.[54] As shown in Table 2, we propose a taxation scheme in which qualifying endowments are very large (more than $500 million) and the proposed excise tax range, based on the tax rate that private foundations are subject to, is small (0.5 percent to 2.0 percent). To help minimize the impact of these assessments on the institutions subject to the tax, we make two recommendations: First, that tax deductions for gifts given to these colleges remain in place. Second, to ensure that the proposed tax does not inadvertently affect the amount that taxed schools set aside for financial aid, and to encourage even higher aid allocations to low- and middle-income students, we recommend that the proposed tax be offset annually by the amount the school appropriates for financial aid to Pell-eligible students.[55]

51 Salmon, F. (2013). *Universities shouldn't be tax exempt.* Retrieved from http://blogs.reuters.com/felix-salmon/2013/07/08/universities-shouldnt-be-tax-exempt/

52 Salmon, F. (2013). *Universities shouldn't be tax exempt.* Retrieved from http://blogs.reuters.com/felix-salmon/2013/07/08/universities-shouldnt-be-tax-exempt/; Unz, R. (2012, Dec. 4). Paying tuition to a giant hedge fund. *The American Conservative.* Retrieved from http://www.theamericanconservative.com/articles/paying-tuition-to-a-giant-hedge-fund/; Lowrey, A. (2014, September. 9). Take away Harvard's nonprofit status. *New York Magazine.* Retrieved from http://nymag.com/daily/intelligencer/2014/09/take-away-harvards-nonprofit-status.html

53 See the report on the "Voluntary Support of Education" survey by the Council for Aid to Education in: Will, M. (2015, January 28). 'Huge explosion of wealth' drives record $37.5-billion in gifts to colleges. *The Chronicle of Higher Education.* Retrieved from http://chronicle.com/article/Huge-Explosion-of-Wealth-/151403/

54 See, for example: Lowrey, A. (2014, September. 9). Take away Harvard's nonprofit status. *New York Magazine.* Retrieved from http://nymag.com/daily/intelligencer/2014/09/take-away-harvards-nonprofit-status.html; Povich, E. S. (2015, March 5). Should nonprofits have to pay taxes? *The Pew Charitable Trusts.* Retrieved from http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2015/3/05/should-nonprofits-have-to-pay-taxes; Miller, J. D. (2008, May 19). Massachusetts should tax Harvard. *Inside Higher Ed.* Retrieved from https://www.insidehighered.com/views/2008/05/19/miller; Vedder, R. K. (2014, February 20). Cut off Harvard to save America. *Bloomberg View.* Retrieved from http://www.bloombergview.com/articles/2014-02-19/cut-off-harvard-to-save-america; Schworm, P., & Viser, M. (2008, May 8). Lawmakers target $1b endowments. *The Boston Globe.* Retrieved from http://www.boston.com/news/local/articles/2008/05/08/lawmakers_target_1b_endowments/?page=full; Lederman, D. (2008, May 1). Endowment debate seeps into the states. *Inside Higher Ed.* Retrieved from https://www.insidehighered.com/news/2008/05/01/mass

55 To smooth out volatility, the tax should be based on a five-year moving average of earnings net of any allowable offsets. This is similar to the method many colleges use to determine endowment spending.

Table 2: Proposed Annual Excise Tax Rates, Number of Colleges Affected and Expected Tax Revenue Based on 2014 Endowment Size

Size of Endowment	Number of Private Colleges Affected	Tax Rate	Total Endowment	Expected Tax Revenue
>$3 Billion	20	2.0%	$210,621,635,000	$4,212,433,000
>$2 Billion	8	1.5%	$18,057,573,000	$270,864,000
>$1 Billion	28	1.0%	$39,003,557,000	$390,036,000
>$0.5 Billion	39	0.5%	$27,816,551,000	$139,083,000
TOTAL	**95**	**~1.36%**	**$295,499,316,000**	**$5,012,416,000**

Source: 2014 NACUBO-Commonfund Study of Endowments[56]

As Table 2 shows, applying the sliding scale to 2014 endowment results yields—prior to any offsets—more than $5 billion, thereby leaving a substantial amount that could be used to increase student success. Table 2 also demonstrates the extent to which endowments are so unequally distributed that few institutions (and students) would be affected by the proposed assessment.

Overall, in 2014 there were only 95 private colleges with endowments over $500 million and therefore subject to the proposed excise tax. These institutions represent only a small fraction of the private colleges in the country and educate fewer than 5 percent of students enrolled in the nation's postsecondary institutions. More importantly, given the extremely unequal distribution of endowments, *more than 84 percent of the revenues would come from only 20 colleges and universities, which last year educated fewer than 2 percent of all students enrolled in the nation's two- and four-year institutions.* The remaining 16 percent of tax revenue would come from another 75 schools that enroll about 2.5 percent of the nation's postsecondary students.

This excise tax, when properly articulated by policymakers,[57] should not only encourage the taxed institutions to allocate a larger share of their endowments to financial aid for their low-income students, but also provide billions of dollars annually to improve the education of millions of low-income and middle-class students served by hundreds of public institutions.

To do so, the revenue raised from the excise tax would be used solely for the benefit of students attending community colleges—institutions that are seriously underresourced yet responsible for training much of the nation's workforce. We believe that this can be done in a revenue-neutral manner that also incentivizes corporations to strengthen their support of local community colleges. To accomplish this, we propose that a new charitable tax credit be established that builds on the tax legislation that created several types of tax credit bonds under the Internal Revenue Code.

The proposed taxing arrangement is revenue neutral because the revenue from the excise tax would match the amount offset by the tax credit gained by participating individuals or corporations. In effect, if a taxpayer gave, for example, $1 million to a community college, he or she would gain a percentage of credit against taxes owed. The total amount of extra tax credit allowed by the program would offset the amount of revenue raised by the excise tax on the large endowments. In turn, the value of the tax credits would match the annual flow of money available to community colleges for qualified purposes. A competitive grant process could be used to ensure that selected community colleges applied the funds to support practices proven effective in promoting student success.

56 NACUBO. (2015). *U.S. and Canadian institutions listed by Fiscal Year (FY) 2014 endowment market value and change in endowment market value from FY2013 to FY2014.* Retrieved from http://www.nacubo.org/Documents/EndowmentFiles/2014_Endowment_Market_Values_Revised.pdf

57 It is not the authors' intention to detail the performance measures and related criteria that could be used to determine which schools and programs the proposed tax revenue should support. We consider that a matter to be determined by higher education experts working with relevant government officials.

As did previous qualified tax credit bonds administered by Treasury and used to support a variety of educational and energy initiatives, these charitable tax credits provide an attractive opportunity for corporations or others seeking to reduce their tax burden in a socially responsible manner.

Similar to the way Treasury issued the tax credit bonds to support specific activities that satisfied criteria set by rules, regulations, or legislation, the tax credit would not be available to everyone. A panel of experts would be established with responsibility for judging the applications and making awards based on the conformance of the application to the established criteria.

In effect, the proposed tax credits can build on these past procedures to support the implementation of practices that have proven to benefit community college students. The following outlines a possible implementation strategy:

First, Treasury would estimate the annual yield of the excise tax on endowments over $500 million.

Second, Treasury would fix the amount to be offset through the tax credits to equal that yield.

Third, ED would establish a panel of experts to determine the qualifying criteria and evaluate the proposals from community colleges. ED would then issue a request for proposals from community colleges. The call would specify that only activities with evidence that they are associated with student success—measured by indicators such as increased student progression, retention, completion, or job placement—would qualify for financial support.

Fourth, interested community colleges would help identify taxpayers interested in the tax credits. This effort would help promote links between colleges and corporations that are critical to resolving the current gaps between what is taught and the workplace skills and competencies that industries need.

Periodic evaluation of the effectiveness of the program would ensure its continual improvement.

President Obama, fearing that his free community college plan would fail to garner Republican support, stated that "If Republicans disagree with the way I'm trying to solve these problems, they should put forth their own plans, and I'll be happy to look at them. But what we can't do is ignore the problems."[58] We agree. The problems faced by higher education, such as low completion rates, cannot be ignored, and fixing them is expensive. In response to President Obama's challenge, and with the hope that bipartisan support will make some version of it a reality, we propose this excise tax—a tax whose time has come.

58 Mangan, K. (2015, February 6). Obama says students should 'get the best skills possible,' quickly and cheaply. *The Chronicle of Higher Education*. Retrieved from http://chronicle.com/article/Obama-Says-Students-Should/151733/

APPENDIX A

Details on Methods and Calculations

Because the IPEDS data on income (for schools that use GASB) and investment return (for schools using FASB) [59] do not distinguish recognized as opposed to unrecognized gains, we substituted as a proxy[60] for realized gains the difference between the 2013 and 2014 endowment results using the summary of the National Association of College and University Business Officers (NACUBO)-Commonfund Study of Endowments.[61]

To determine the value of the tax-exempt status under federal and state law, for each of the 60 institutions in our study, we multiplied the resulting difference by the average effective combined state and federal long-term capital gains rate from 2013.[62] Lastly, we took this figure and divided it by the institution's total FTE (the sum of the undergraduate and graduate FTE). These data, along with appropriations data, come from IPEDS Academic Year (AY) 2012–13, the latest year for which these data are available.[63]

To calculate the appropriations per FTE we combined the federal, state, and local appropriations per institution from IPEDS for AY 2012–13 and divided this by total FTE.[64]

Finally, we summed the value of the state and federal long-term capital gains tax exemption and appropriations per FTE for each institution to determine the taxpayer investment per FTE.

From IPEDS, we gathered the percent of undergraduate students receiving Pell Grants in AY 2012–13 for each institution and used the median figure for each category of institutions used in this report.

Data on 2014 endowments came from the NACUBO-Commonfund Study of Endowments.[65] Using this source, we placed each private institution in one of four categories based on the size of their endowment ($3B+, $2B+, $1B+, $500M+). Because we wanted to minimize the possibility that the proposed excise tax would negatively affect the amount of their endowment

59 We recognize that these two measures are not identical. See: Delta Project. (2011). *Delta cost project documentation of IPEDS database and related products*. Retrieved from http://nces.ed.gov/ipeds/deltacostproject/download/DCP_History_Documentation.pdf. We have not been able to find an estimate of the size of the difference that these reporting standards generate. However, this issue is germane only to a comparison across schools in the not-for-profit versus public sectors, because most private schools use FASB while most government schools use GASB (with the exception of public institutions in Pennsylvania). Additionally, the size of the differences within the private sector and the size of the differences between the best-endowed private schools and the flagships cannot be explained away by differences between these two accounting systems.

60 As previously noted (Footnote 18), after substantial consultation, we settled for a proxy on the delta between annual endowment results. We recognize this solution is not perfect, but other alternatives we explored—in the absence of the relevant data—were found to be too speculative for this study. *This is why one of our recommendations is greater transparency in reporting of endowment returns.*

61 NACUBO. (2015). *U.S. and Canadian institutions listed by Fiscal Year (FY) 2014 endowment market value and change in endowment market value from FY2013 to FY2014.* Retrieved from http://www.nacubo.org/Documents/EndowmentFiles/2014_Endowment_Market_Values_Revised.pdf

62 See Table 1 in: Pomerlau, K. (2013, February 2013). *The high burden of state and federal capital gains tax.* Retrieved from http://taxfoundation.org/article/high-burden-state-and-federal-capital-gains-taxes

63 National Center for Education Statistics. (n.d.). *IPEDS data center.* Retrieved from http://nces.ed.gov/ipeds/datacenter/

64 We recognize that for some institutions with a research mission, the appropriations received are not all used to support the education of their students. For example, federal appropriations are sometimes received by institutions to run research laboratories for the government. We did not include these appropriations because we could not properly account for them with existing data sources.

65 NACUBO. (2015). *U.S. and Canadian institutions listed by Fiscal Year (FY) 2014 endowment market value and change in endowment market value from FY2013 to FY2014.* Retrieved from http://www.nacubo.org/Documents/EndowmentFiles/2014_Endowment_Market_Values_Revised.pdf

institutions use for financial aid and operations, we proposed exempting endowments under $500 million. Public institutions were also excluded because the funds made available through the proposed excise tax are expected to be used for the improvement of public regional and community colleges.[66]

Using the NACUBO-CSE source, we calculated how many colleges were in each category and the sum total endowment across those institutions. We proposed a sliding excise tax based on the wealth of schools in each category, ranging from 0.5 percent to 2 percent, in keeping with the tax rate to which private foundations are already subject. Using these tax rates, we estimate that the proposed tax would generate around $5 billion, nearly 85 percent of what the President proposed to finance his free community college plan per year over the next 10 years.[67]

66 Endowments at some public institutions, such as at the University of California, Berkeley, are also being used to make up for the cuts in state support (Carol T. Christ, personal communication).

67 For estimates of costs after the first ten years, see: Kelly, A. P., & James, K. J. (2015, February 3). How much will free community college cost? American Enterprise Institute. Retrieved from https://www.aei.org/publication/much-will-free-community-college-cost/

APPENDIX B

Colleges and Universities in the Study

Table B.1: Names of Colleges and Universities in the Study and Criteria for Selection

Private Not-for-Profit, High Endowment: Selected for having the largest endowment in 2013 in 10 distinct states	
CA	Stanford University
CT	Yale University
IL	University of Chicago
IN	Notre Dame University
MA	Harvard University
NC	Duke University
NJ	Princeton University
NY	Columbia University
PA	University of Pennsylvania
TX	Rice University

Private Not-for-Profit, Medium Endowment: Selected for being a four-year school in the same 10 states and having a medium-sized endowment as calculated using http://chronicle.com/article/Sortable-Table-College-and/144241/	
CA	Biola University
CT	Connecticut College
IL	North Central College
IN	Indiana Wesleyan University
MA	Bentley University
NC	Guilford College
NJ	Rider University
NY	Alfred University
PA	Robert Morris University
TX	University of the Incarnate Word

Private Not-for-Profit, Low Endowment: Selected for being a four-year school in the same 10 states and having a low endowment as calculated using http://chronicle.com/article/Sortable-Table-College-and/144241/	
CA	Holy Names University
CT	University of Saint Joseph
IL	Olivet Nazarene University
IN	Saint Mary-of-the-Woods College
MA	Labouré College
NC	High Point University
NJ	Centenary College
NY	Keuka College
PA	Keystone College
TX	Texas College

Flagship: Selected for being a highly rated research institution in the same 10 states.	
CA	University of California, Berkeley
CT	University of Connecticut
IL	University of Illinois, Urbana-Champaign
IN	Indiana University, Bloomington
MA	University of Massachusetts, Amherst
NC	University of North Carolina, Chapel Hill
NJ	Rutgers University
NY	Stony Brook University
PA	Pennsylvania State University, University Park
TX	University of Texas, Austin

Regional: Selected for being the largest regional campus in the same 10 states whose admission competitiveness is categorized as "Competitive" in Barron's Profiles of American Colleges 2013.[68]	
CA	California State University, Fullerton
CT	Central Connecticut State University, New Britain
IL	Western Illinois University, Macomb
IN	Indiana State University, Terre Haute
MA	MA – Bridgewater State University, Bridgewater
NC	University of North Carolina, Charlotte
NJ	Montclair State University, Montclair
NY	City University of New York, Queens College
PA	Indiana University of Pennsylvania-Main Campus
TX	Texas State University, San Marcos

Community College: Selected for being the largest community college near the selected regional campus in the same 10 states.	
CA	Fullerton College
CT	Tunxis Community College
IL	Waubonsee Community College
IN	Ivy Tech Community College
MA	Massasoit Community College
NC	Central Piedmont Community College, Charlotte
NJ	Essex County College
NY	Queensborough Community College
PA	Westmoreland County Community College
TX	Austin Community College, San Marcos

68 Barron's Educational Series, Inc. (2013). B*arron's profiles of American colleges 2013.* Hauppauge, NY.

Table B.2: Percent of Students With Pell Grants in the Schools in the Study, AY 2012–13

Percent Pell						
State	**Private – High Endowment**	**Private – Medium Endowment**	**Private – Low Endowment**	**Flagship College**	**Regional College**	**Community College**
CA	16	31	46	32	41	25
CT	13	13	37	21	33	35
IL	14	24	32	20	43	30
IN	12	39	51	19	43	55
MA	10	16	37	25	24	41
NC	14	50	13	21	40	41
NJ	12	26	27	31	37	59
NY	22	38	37	35	38	47
PA	14	35	45	18	36	42
TX	17	42	100	27	35	26
MEDIAN	**14**	**33**	**37**	**23**	**38**	**41**

Table B.3: Total Undergraduate and Graduate FTE Student Enrollment and Total Number of Students in Each of the 60 Schools in the Study, AY 2012–13

Total FTE						
State	Private – High Endowment	Private – Medium Endowment	Private – Low Endowment	Flagship College	Regional College	Community College
CA	14,410	5,325	1,167	37,127	28,947	11,124
CT	13,121	2,068	1,790	22,037	9,989	2,787
IL	12,699	2,860	4,731	47,528	10,755	7,698
IN	12,214	13,681	738	39,039	10,925	71,493
MA	20,857	5,229	554	27,798	9,802	5,442
NC	14,652	2,211	2,313	24,946	22,807	15,889
NJ	8,096	4,960	2,271	39,388	16,277	9,595
NY	23,396	2,411	1,833	22,071	15,769	11,931
PA	19,438	5,140	1,822	45,483	14,471	4,669
TX	6,713	6,875	788	45,500	29,202	25,957

Total Students (All Levels)						
State	Private – High Endowment	Private – Medium Endowment	Private – Low Endowment	Flagship College	Regional College	Community College
CA	18,519	6,303	1,353	35,893	37,677	19,624
CT	11,906	1,933	2,525	25,483	12,091	4,734
IL	15,245	3,042	4,512	44,520	12,205	11,146
IN	12,126	15,580	1,030	42,133	12,114	100,272
MA	28,147	5,647	727	28,236	11,417	8,209
NC	15,386	2,462	2,359	29,278	26,232	19,498
NJ	7,975	5,485	2,576	40,434	18,382	11,979
NY	26,471	2,362	2,772	23,946	20,100	15,711
PA	24,725	5,439	1,683	45,783	15,596	6,571
TX	6,484	8,442	845	52,186	34,225	43,315

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3701 Sacramento Street, Unit 297
San Francisco, CA 94118
www.nexusresearch.org