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Why the Charitable Deduction for Gifts to Educational Endowments Should Be Repealed

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Why the Charitable Deduction for Gifts to Educational Endowments Should Be Repealed

HERWIG SCHLUNK*

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INTRODUCTION

The country's collective patience for coddling private institutions of higher education is waning. At the local level, there is an effort afoot to challenge the tax-exempt status of Princeton University.¹ At the state level, legislators in Massachusetts and Connecticut have suggested imposing taxes that would target Harvard University and Yale University.² At the federal level, a number of proposals

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¹ See Elise Young, *Princeton's Neighbors Say to Heck With Freebies—We Want Cash*, BLOOMBERG (May 2, 2016, 5:00 AM), <http://www.bloomberg.com/news/articles/2016-05-02/princeton-s-neighbors-say-to-heck-with-freebies-we-want-cash> (noting a challenge to the tax-exempt status of Princeton University, and also noting rhetoric from mayors in Boston, Chicago, and New Orleans aimed at collecting revenue from local private universities).

² See, e.g., Peter Schworm & Matt Viser, *Lawmakers Target \$1B Endowments*, BOSTON.COM (May 8, 2008), http://archive.boston.com/news/local/massachusetts/articles/2008/05/08/lawmakers_target_1b_endowments/ (reporting on consideration by the Massachusetts legislature of a plan to impose a 2.5% tax on

have been floated that would impact the tax treatment of universities and their endowments, including imposing an excise tax on endowment income.³

In this paper, I will add my voice to the chorus of those who

endowments in excess of \$1 billion, which would have affected not merely Harvard University, but also Amherst College, Boston College, Boston University, Massachusetts Institute of Technology, Smith College, Tufts University, Wellesley College, and Williams College); Michelle Liu, *State Aims to Tax University Endowment*, YALE DAILY NEWS (March 23, 2016), <http://yaledailynews.com/blog/2016/03/23/state-aims-to-tax-university-endowment/> (reporting on two bills introduced in Connecticut: S.B. 413, which would tax private university endowments worth over \$10 billion, and S.B. 414, which would increase the amount of private university property subject to local property tax).

³ Although no legislation resulted, in 2008, the Senate Finance Committee considered imposing a 5% annual spending requirement on university endowments. See Alex Bloom, *Iowa Senator Defends Inquiry, 5 Percent Spending Minimum*, CBS NEWS (March 12, 2008), <http://www.cbsnews.com/news/iowa-senator-defends-inquiry-5-percent-spending-minimum/>. Per Senator Chuck Grassley (R-Iowa), the reason for the proposal was that “Tuition has gone up, college presidents’ salaries have gone up, and endowments continue to go up and up . . . It’s fair to ask whether a college kid should have to wash dishes in the dining hall to pay his tuition when his college has a billion dollars in the bank.” See *Baucus, Grassley Write to 136 Colleges, Seek Details of Endowment Pay-Outs, Student Aid*, U.S. S. COMM. FIN. (Jan. 24, 2008), <http://www.finance.senate.gov/record/baucus-grassley-write-to-136-colleges-seek-details-of-endowment-pay-outs-student-aid> (internal quotation marks omitted).

Then, in 2014, House Representative Dave Camp (R-Michigan) included as part of his comprehensive tax overhaul plan the imposition of a 1% excise tax on the net investment income of schools with endowment assets of at least \$100,000 per full-time student. See, e.g., Janet Lorin & Lauren Streib, *House Panel Questions College Endowment Spending, Tax Benefits*, BLOOMBERG (Oct. 7, 2015, 6:32 PM) <http://www.bloomberg.com/news/articles/2015-10-07/house-panel-questions-college-endowment-spending-tax-benefits>; Christine Y. Cahill & Anna H. Hashmi, *Tax Reform Could Cost Harvard Millions, Though Passage Unlikely*, THE HARV. CRIMSON (Apr. 3, 2014), <http://www.thecrimson.com/article/2014/4/3/tax-reform-cost-endowment/>.

Most recently, in 2016, House Representative Tom Reed (R-New York) resurrected Senator Grassley’s 2008 efforts by proposing that university endowments worth over \$1 billion devote 25% of their annual endowment income to financial aid or risk losing the university’s tax-exempt status. See Janet Lorin, *Richest U.S. Schools Could Lose Tax Status in Endowment Proposal*, BLOOMBERG (Jan. 8, 2016, 5:00 AM), <http://www.bloomberg.com/news/articles/2016-01-08/richest-u-s-schools-could-lose-tax-status-in-endowment-proposal>. This proposal would currently affect 92 institutions. See *id.* Given the state of gridlock in Washington, D.C., chances of enactment are currently at best remote.

would change the rules of federal taxation as applied to institutions of higher education. But rather than focus on the taxation of such institutions directly, I will instead focus on the propriety of granting such institutions the ability to receive gifts that are tax-deductible by the donor. I argue that in the specific and limited context of gifts made to university endowments, an adequate defense for providing the tax preference of a charitable contribution deduction is lacking.

I. TAX EXEMPTIONS FOR EDUCATIONAL INSTITUTIONS

In a world in which most activities are not taxed, the power to tax is surely “the power to destroy.”⁴ Conversely, in a world in which most activities are taxed, the willingness to forego full taxation, whether by granting a tax deduction to persons funding an activity,⁵ by granting a tax exemption to the actual conduct of the activity,⁶ or perhaps by granting both,⁷ is an exercise of the power to establish any activity that is not fully taxed.⁸ The reason is that when the federal government grants an activity the privilege to receive tax-advantaged funding (e.g., by way of allowing it to receive tax-deductible charitable contributions)⁹ and/or grants to those persons who conduct the activity the privilege to conduct their activity in a

⁴ *McCulloch v. Maryland*, 17 U.S. 316, 431 (1819).

⁵ *See, e.g.*, I.R.C. § 170(a)(1) (West 2014) (codified as 26 U.S.C. § 170(a)(1)) (allowing federal income tax deductions to taxpayers who contribute to charitable organizations).

⁶ *See, e.g.*, I.R.C. § 501(c)(3) (West 2014) (codified as 26 U.S.C. § 501(c)(3)) (exempting charitable and religious organizations from federal income tax).

⁷ Taken together, I.R.C. §§ 170(a)(1) and 501(c)(3) provide both tax-deductible contributions and tax-exempt “income” for certain non-profit organizations. *See supra* notes 5–6.

⁸ *See* Erika King, *Tax Exemptions and the Establishment Clause*, 49 SYRACUSE L. REV. 971, 994 (1999) (“[G]ranteeing a taxpayer an exemption from a tax that would otherwise accrue (i.e., from the ‘normative tax’) is the same—in purpose and in effect—as *collecting* that tax and giving the taxpayer a *direct subsidy*.”) (internal parentheses in original). *But cf.* *Walz v. Tax Comm’n of N.Y.*, 397 U.S. 664, 672 (1969) (“The legislative purpose of a property tax exemption is neither the advancement nor the inhibition of religion; it is neither sponsorship nor hostility.”).

⁹ *See* I.R.C. § 170(a)(1) (codified as 26 U.S.C. § 170(a)(1)).

tax-exempt manner,¹⁰ it cedes to such activity a part of what would otherwise be *its* general revenue.¹¹

As is the case with any “tax expenditure,” the federal government could have used the revenue lost to the establishment of the favored activity to provide additional benefits to society.¹² Or if sufficient benefits were already being provided, the federal government could have defrayed a part of the cost of such benefits and thus ultimately lowered the tax burdens imposed on persons conducting less favored activities.¹³ Phrased somewhat more provocatively, we all pay for these favored activities—because of them, we either receive fewer government benefits or pay higher taxes than we otherwise would.¹⁴ Given this reality, the federal government ought to bear a

¹⁰ See I.R.C. § 501(a) (codified as 26 U.S.C. § 501(a)).

¹¹ See, e.g., Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1158 (1988) (“[A] preferential tax provision operates in two steps: first the taxpayer pays the government the [tax] called for . . . in the absence of the preferential provision, and then the government gives the taxpayer a government grant or subsidy . . . [T]he government makes the subsidy payment by reducing the taxpayer’s tax liability.”). See also STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* 3 (1985) (“Put differently, whenever government decides to grant monetary assistance to an activity or group, it may choose from a wide range of methods, such as . . . [reducing] the tax liability otherwise applicable by adopting a special exclusion, deduction, or the like for the favored activity or group.”).

¹² See Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 713 (1970) (“We can assume it is understood that each incentive must serve purposes which the nation wants to achieve and is willing to finance, rather than let the marketplace determine the extent to which the result will obtain.”).

¹³ Confirmation of this possibility can be found in the fact that the Office of Management and Budget annually publishes a “tax expenditure” budget to accompany the publication of the Budget of the U.S. Government. See generally, e.g., OFF. MGMT. & BUDGET, *ANALYTICAL PERSPECTIVES, BUDGET OF THE U.S. GOVERNMENT, FISCAL YEAR 2016* 219–64 (2015). See also NORTON FRANCIS ET AL., TAX POL’Y CTR., *What are tax expenditures and how are they structured?*, in *THE TAX POLICY BRIEFING BOOK: A CITIZENS’ GUIDE TO THE TAX SYSTEM AND TAX POLICY* available at <http://www.taxpolicycenter.org/briefing-book/background/expenditures/budget.cfm> (last visited Mar. 11, 2017).

¹⁴ See, e.g., David I. Walker, *Suitable for Framing: Business Deductions in a Net Income Tax System*, 52 WM. & MARY L. REV. 1247, 1254 (2011) (“[T]he difference between tax subsidies and direct spending is illusory. The government can influence the allocation and distribution of societal resources through either avenue, but the use of a tax subsidy instead of direct spending creates an illusion

heavy burden to justify granting the privileges of tax-deductible funding and/or tax-exempt operations to any activity.¹⁵

The only truly satisfactory justification for granting these privileges to any particular activity is that such grant does not in fact impose a burden on the remainder of society.¹⁶ That prerequisite is most easily and obviously satisfied if the federal government would, in the absence of such a grant, itself provide the service that the tax-favored activity provides, though presumably not as efficiently.¹⁷ At least in the case of the grant of tax preferences to private universities, this sounds like a plausible justification.¹⁸ In many, even most,

of smaller government from a fiscal perspective because the tax subsidy appears to reduce taxes and spending. Although an illusion, the appearance affects reception and helps to explain the popularity of various tax programs.”)

¹⁵ Cf. *Harding Hosp., Inc. v. United States*, 505 F.2d 1068, 1071 (6th Cir. 1974) (“An exemption is an exception to the norm of taxation. An organization which seeks to obtain tax exempt status, therefore, bears a heavy burden to prove that it satisfies all the requirements of the exemption statute.”).

¹⁶ But see, e.g., Daniel S. Goldberg, *Tax Subsidies: One-Time Vs. Periodic: An Economic Analysis of the Tax Policy Alternatives*, 49 TAX L. REV. 305, 308 n.16 (1994) (“[T]ax incentives create[] undue tax complexity [Also,] . . . those taxpayers who [are] in the highest tax bracket receive[] the greatest tax reduction from the more common tax incentive provisions that operate[] through exemptions or deductions . . .”).

¹⁷ See Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C.L. REV. 501, 577 (1990) (“Accordingly, the result of their collective decision-making will be to provide public goods at the level of quality and quantity that satisfies the demands of the median voter. Voters who prefer different levels, whether higher or lower, will thus be left dissatisfied with governmental provision of public goods.”).

¹⁸ See, e.g., Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 66 (1981) (“A . . . common view of the exemption is [as] a means of subsidizing particular services—such as health care, education, research, and aid to the poor—that nonprofit organizations often provide . . . that otherwise would have to be provided by the government . . .”). See also Henry Hansmann, Professor of L., Yale Law Sch., *Why Are Colleges and Universities Exempt from Taxes?*, Essay Prepared for the National Center for Philanthropy and the Law’s 25th Annual Conference: “Colleges and Universities: Legal Issues in the Halls of Ivy” 4–11 (Oct. 24–25, 2013) (transcript available in the New York University School of Law Library) (discussing other rationales for subsidizing higher education and briefly mentioning the United States’s experimentation with for-profit higher education).

developed countries, the public sector is the almost exclusive provider of higher education.¹⁹ We too could follow those countries' collective lead and have the federal government impose additional taxes to fund the provision of higher education.²⁰ Indeed, we do follow this lead to a significant extent, albeit mostly indirectly: the federal government provides students with financial assistance, universities with research grants and other revenue streams, and states with funding that helps them to establish and maintain public universities.²¹

Why do we tolerate the alternative of private universities financed largely by tax preferences? Why do we allow taxpayers to divert what would otherwise be public funds to what is essentially the private sector, so long as that sector uses such funds to provide what are essentially public services? Before examining the reasons that have been identified to justify this use of tax preferences to encourage the growth of a "private" industry to satisfy a public goal, I want to remind the reader why we in the United States favor such hybrid structures for organizing industries: we prefer limited government,²² we believe that the private sector can do almost anything

¹⁹ See, e.g., Andrew Kelly, *America's High-Risk, High-Reward Higher Education System*, FORBES (Mar. 1, 2015, 12:25 PM), <http://www.forbes.com/sites/akelly/2015/03/01/americas-high-risk-high-reward-higher-education-system/2/> ("Higher education [in countries other than the United States] is free or extremely low-cost, but access to academic degree programs at top universities is heavily rationed.").

²⁰ See *id.*

²¹ Financial assistance to students may or may not be based on need. See, e.g., 20 U.S.C. § 1070a(a)(1) (West 2014) (providing Pell grants to eligible students). Federal education funding to states encourages states to provide higher education services through state-established public universities. See, e.g., TENN. CODE ANN. § 49-9-102(b)(1)–(2) (West 2014) (accepting federal funding for higher education). The federal government also provides higher education services directly to a very limited extent at West Point and other military academies. See, e.g., 10 U.S.C. § 2161 (West 2014) (describing schools run by the Department of Defense).

²² See, e.g., Jeffrey M. Jones, *Americans Remain Divided on Preference for Gov't Activity*, GALLUP (Sept. 29, 2014), <http://www.gallup.com/poll/177422/americans-remain-divided-preference-gov-activity.aspx> ("54% of Americans say the government is 'trying to do too many things that should be left to individuals and businesses.'").

better than the public sector,²³ and we treat the competitive market as a holy grail.²⁴ All else being equal, we believe that private universities will necessarily provide “better” educational services than public universities.²⁵

²³ See, e.g., Chris Edwards, *Government Infrastructure Is Inefficient Everywhere*, CATO INST.: CATO AT LIBERTY (Mar. 19, 2014, 5:23 PM), <http://www.cato.org/blog/government-infrastructure-inefficient-everywhere> (using government dam projects as an egregious example of government cost overruns); *Millennials Think Government is Inefficient, Abuses its Power, and Supports Cronyism*, REASON.COM (July 10, 2014, 8:02 AM), <http://reason.com/poll/2014/07/10/reason-rupe-2014-millennial-survey> (arguing that millennials see the government as inefficient and wasteful though they support government action in several specific areas). But see BUREAU OF LAB. STAT., U.S. DEP’T OF LAB., USDL-16-2255, EMPLOYER COSTS FOR EMPLOYEE COMPENSATION—SEPTEMBER 2016 1 (Dec. 8, 2016), available at <http://www.bls.gov/news.release/pdf/ecec.pdf> (showing that the hourly cost to employers for compensating government workers was merely \$13.66 more than workers in the private sector); Joseph Slater & Elijah Welenc, *Are Public-Sector Employees “Overpaid” Relative to Private-Sector Employees? An Overview of the Studies*, 52 WASHBURN L.J. 533, 541–42 (2013) (noting that studies agree that higher-level public employees are paid less than their private-sector counterparts, whereas as lower-level public employees tend to be paid a little more).

²⁴ Compare Jonathan Haidt, *Capitalism As Our Greatest Hope*, THE WORLD POST (Aug. 16, 2013, 9:58 AM), http://www.huffingtonpost.com/jonathan-haidt/capitalism-as-our-greates_b_3600792.html (“I think in the long run our greatest hope is capitalism What I’m hoping is that we as Americans, and people in other countries, too, can think more clearly about capitalism as the engine of growth that lifts people out of poverty.”), with Robert Reich, *The Myth of the ‘Free Market’ and How to Make the Economy Work for Us*, THE HUFFINGTON POST (Sept. 16, 2013, 12:06 PM), http://www.huffingtonpost.com/robert-reich/free-market_b_3935173.html (“One of the most deceptive ideas continuously sounded by the Right (and its fathomless think tanks and media outlets) is that the ‘free market’ is natural and inevitable, existing outside and beyond government.”) (internal parentheses in original).

²⁵ See, e.g., Joni Hersch, *Catching Up Is Hard To Do: Undergraduate Prestige, Elite Graduate Programs, and the Earnings Premium* 3 (Vanderbilt Univ. Law Sch. Law & Econ., Working Paper No. 14-23), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2473238 (finding that data demonstrates an earnings premium for male students who graduate from elite undergraduate institutions). But see Deborah L. Jacobs, *Public or Private College. Is The Outcome Any Different?*, FORBES (Oct. 2, 2013, 8:58 AM), <http://www.forbes.com/sites/deborahljacobs/2013/10/02/public-or-private-college-is-the-outcome-any-different/> (arguing that, given the rising costs of higher education, private education is not worth the additional money spent).

Yet, the mere coexistence of public and private universities belies the proposition that private universities provide better educational services than public universities in any meaningful sense. For example, if private universities provided the same quality of education, but did so more cheaply, one would expect public universities to be driven out of the market. Similarly, if they offered a higher quality of education, but at the same price, one would again expect public universities to be driven out of the market. So, assuming the market works,²⁶ private universities must provide a different quality of education at a different price, with some consumers preferring one quality-price combination and others preferring the other. Of course, even if taxpayers understood that choice was the only thing that the grant of tax preferences to private universities was buying, support for such preferences would not necessarily evaporate.²⁷ Americans love choice.²⁸ And in light of recent experiences, we could be forgiven for deeming the availability of merely for-profit

²⁶ The market may not work for education considering the massive amount of direct and indirect government intervention. See George Leef, *The Growing Potential of Free Market Education*, FORBES (Feb. 7, 2012, 10:41 AM), <http://www.forbes.com/sites/realspin/2012/02/07/the-growing-potential-of-free-market-education/>; Valerie Strauss, *Why the 'Market Theory' of Education Reform Doesn't Work*, WASH. POST (Oct. 12, 2012), <http://www.washingtonpost.com/blogs/answer-sheet/wp/2012/10/12/why-the-market-theory-of-education-reform-doesnt-work/> (arguing that when parents are given an educational “free market,” they actually do not prioritize educational quality when choosing a particular school for their children).

²⁷ Cf. Arianna Prothero, *Charters & Choice News Roundup: Unions vs. School Choice*, EDUC. WEEK BLOGS: CHARTERS & CHOICE (Mar. 6, 2015, 10:29 AM), http://blogs.edweek.org/edweek/charterschoice/2015/03/charters_choice_news_roundup_unions_vs_school_choice.html?print=1 (describing recent experimentation with charter schools and school voucher programs at the state and local levels).

²⁸ See, e.g., Art Markman, *The Dark Side of Choice in America*, THE HUFFINGTON POST: BLOG (Aug. 4, 2011, 10:31 AM), http://www.huffingtonpost.com/art-markman-phd/dark-side-of-choice_b_888751.html (“A big part of our identity is the freedom of choice. The strong libertarian streak that runs through American politics reflects a don’t-tread-on-me spirit that has been part of our national identity since Revolutionary War times.”).

alternatives such as DeVry University or ITT Educational Services to represent insufficient choice.²⁹

II. THE THEORETICAL DEFENSE OF THE CHARITABLE CONTRIBUTION DEDUCTION

Legal commentators have proposed three rationales to justify the use of tax preferences to achieve public goals and, in particular, to justify the grant to certain institutions of the privilege to receive funding by way of tax-deductible contributions.³⁰ One could apply each of these rationales to the goal of providing higher education (or to the lesser goal of multiplying choices in higher education).³¹

First, such tax deductions encourage generosity and thus maximize the total amount of societal resources devoted to the pursuit

²⁹ See *DeVry University Historical Timeline*, DEVRY UNIV., <http://www.devry.edu/community-network/our-heritage.html> (last visited Mar. 11, 2017) (describing how DeVry University is a for-profit university that features online and on-campus classes); Patricia Cohen, *ITT Educational Services Closes Campuses*, N.Y. TIMES (Sept. 6, 2016), <http://www.nytimes.com/2016/09/07/business/itt-educational-services-closes-its-campuses.html> (reporting on the shuttering of ITT Educational Services in the wake of poor educational performance). See also Alia Wong, *The Downfall of For-Profit Colleges*, THE ATLANTIC (Feb. 23, 2015, 1:30 PM), <http://www.theatlantic.com/education/archive/2015/02/the-downfall-of-for-profit-colleges/385810/> (explaining how for-profit colleges and universities have come under intense federal scrutiny because of their poor performance).

³⁰ See, e.g., David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals*, 62 TAX L. REV. 221, 224 (2009) (proposing “three justifications for the [tax] deduction, each responding to a different information or incentive problem that is inherent in the pursuit of public goals”). Throughout this essay, I will treat the privilege of receiving tax-deductible contributions as though it is necessarily coupled with the privilege of operating in a tax-exempt manner. In principle, such coupling is not necessary. After all, one could create a tax scheme in which contributions to private universities were not deductible but in which the operation of such universities were exempt from taxes. Likewise, one could conceive of the converse. Since such intermediate schemes have not been employed in our tax system, however, I will not dwell on them here. See *supra* notes 2–3 (reflecting various proposed plans by state and federal legislatures).

³¹ Cf. Mark J. Cowan, *Taxing and Regulating College and University Endowment Income: The Literature’s Perspective*, 34 J.C. & U.L. 507, 534–37 (2008) (discussing tax subsidy rationales for the tax exemption of higher education).

of public goals.³² To illustrate this point, consider a pool of \$100 million of income that is federally taxable at a flat 30% marginal rate. This pool could conceivably consist of the last \$100 earned by one million different people or the last \$100 million earned by a single billionaire; at this stage of the analysis, it makes no difference.³³ In the absence of contributions to private universities and any attendant tax deductions, this pool generates \$30 million of tax revenue for the pursuit of public goals.³⁴ If, however, contributions to private universities are tax-deductible, and if this deductibility encourages taxpayers to contribute 10% of the income pool to such universities, \$37 million will be generated for the pursuit of public goals.³⁵ True, the federal government loses control over how \$3 million is spent, but presumably the additional \$7 million spent in aggregate more than compensates for this loss of control. See Table 1.1.

Table 1.1 Potential Cash Contribution	No Deduction for Contributions used to Fund Education	Deduction for Contributions used to Fund Education
General Spending Controlled by Federal Government	\$30 million	\$27 million
Education Spending Controlled by Donors	\$0	\$10 million

³² See generally Schizer, *supra* note 30, at 229 (explaining that tax incentives promote charitable giving in part because free riding encourages people to shift the cost of charities' public benefits to others).

³³ See *id.* But see *infra* Part III (discussing how the fact that large gifts to endowments are made by very wealthy individuals impacts whether the additional generosity rationale for tax-deductible higher education contributions makes sense).

³⁴ That is, it generates 30% of \$100 million.

³⁵ In addition to the \$10 million contribution, \$27 million in taxes, or 30% of \$90 million, will continue to be collected.

The arithmetic is more complicated if the income at issue is unrealized capital gain that the taxpayers intend to realize.³⁶ Suppose that such income is taxed at a uniform marginal rate of 15%. In that case, in the absence of any tax-deductible contribution, the federal government receives \$15 million of tax revenue.³⁷ However, due to the perverse operation of the tax code, if \$10 million of the property is contributed to a private university, the federal government does not merely lose \$1.5 million of tax revenue, but rather \$4.5 million, since the amount of deemed realized capital gain declines to \$90 million while the full \$10 million is allowed as an ordinary income deduction.³⁸ Thus, as was the case with a cash gift, the amount generated for the pursuit of public goals increases (now from \$15 million to \$20.5 million), even as the amount controlled by the federal government declines (now from \$15 million to \$10.5 million). See Table 1.2.

Table 1.2 Potential Property Contribution	No Deduction for Contributions used to Fund Education	Deduction for Contributions used to Fund Education
General Spending Controlled by Federal Government	\$15 million	\$10.5 million
Education Spending Controlled by Donors	\$0	\$10 million

³⁶ See generally I.R.C. § 1222 (2012) (codified as 26 U.S.C. § 1222); I.R.C. § 1(h) (West 2014) (codified as 26 U.S.C. § 1(h)).

³⁷ That is, it generates 15% of \$100 million.

³⁸ See I.R.C. § 170(a)(1) (codified as 26 U.S.C. § 170(a)(1)); 26 C.F.R. § 1.170A-1(a) (2015) (allowing an above-the-line deduction for “any charitable contribution”); 26 C.F.R. § 1.170A-1(c) (stating the amount of a contribution of property is the fair market value of the contributed property). Thus, if a 15% tax rate is applied to \$90 million and a 30% tax rate is applied to a lost \$10 million, \$10.5 million of net tax revenue results. Note that the favorable rules have some limitations. See I.R.C. § 170(b)(1)(C)(i)-(ii) (codified as 26 U.S.C. § 170(b)(1)(C)(i)-(ii)) (limiting contribution amounts for capital gain contributions to at least no more than 30% of the taxpayers adjusted gross income for any given year, with any excess available as a carryover for the next five years); I.R.C. § 170(e) (codified as 26 U.S.C. § 170(e)) (reducing contribution amounts for capital gain contributions by their short-term capital gain).

The second benefit alleged to follow from allowing tax-deductible contributions to private universities is that it enables the federal government to invest its resources in a manner that more closely reflects societal preferences.³⁹ For example, in the first illustration above (Table 1.1), the federal government has effectively decided to spend \$3 million of what would have been its general revenue on higher education, but has not engaged in the requisite due diligence that would enable it to devise an efficient strategy for directing such expenditure.⁴⁰ By “piggybacking” its so-called “tax expenditure” onto the “investment” decisions of individual donors, each of whom it hopes is motivated to investigate the quality of the education that his or her contribution ultimately buys, the federal government can optimize the value of its own co-investment.⁴¹ Table 2.1 treats the federal government’s tax revenue loss from the contribution deduction as just such a targeted piggybacked tax-expenditure investment:\

Table 2.1	Grant of Federal Revenue to State to Fund Education	Deduction for Contributions used to Fund Education
Non-Education Spending Controlled by Federal Government	\$27 million	\$27 million
Education Spending Controlled by Federal Government	\$3 million	\$0
Education Spending Delegated by Federal Government to Donors	\$0	\$3 million ⁴²
Education Spending Controlled by Donors	\$0	\$7 million

³⁹ See generally Schizer, *supra* note 30, at 229–30.

⁴⁰ See *supra* Table 1.1.

⁴¹ See Schizer, *supra* note 30, at 229 (“[S]ubsidized charity can serve as a means for identifying and reflecting popular preferences, since the government invests money only when individual donors do so as well.”).

⁴² The federal government would spend this money indirectly by allowing taxpayers a deduction on their federal income tax for amounts they contribute to universities.

The third alleged benefit, which is the *ex-post* counterpart to the second, is that private donors may be better able than the federal government to monitor the quality of educational services they fund.⁴³ That is, private donors are not only likely to investigate potential donee universities before making their contributions, but are also likely to monitor them after making their contributions.⁴⁴

Before examining these purported benefits more closely, I should modify Table 2.1 to more accurately reflect how “direct” funding for higher education operates under our federal system. To wit, the federal government delegates to states effectively all of the implementation for providing such education.⁴⁵ Once the decision to delegate has been made, the federal government has essentially two ways to proceed. First, the federal government could make an outright grant to one or more states to fund their provision of higher education.⁴⁶ In the first column of Table 2.2 below, the federal government takes the \$3 million of its general tax revenue that it has decided to devote to higher education and gives it to one or more states.

Second, the federal government could encourage states to exercise their own taxing powers to fund state universities by making the

⁴³ See Schizer, *supra* note 30, at 230 (“[A]gents are tempted to shirk or to behave self-interestedly, and principals may not have enough information to know they are doing so. ‘Implementation error’ is . . . the welfare costs from poor or costly administration. Minimizing this . . . error is a third objective in designing a subsidy for charitable contributions.”).

⁴⁴ See *id.* at 256 (“Since they are contributing their own money, donors have the incentive to assess whether their gifts are having a positive impact. When the donor is capable of making a large contribution, moreover, she is likely to have influence with the nonprofit manager.”).

⁴⁵ See 20 U.S.C. § 1001 (2012) (defining an “institution of higher education” eligible for federal funding as an educational institution “legally authorized within such State to provide a program of education beyond secondary education . . .”). See also 34 C.F.R. § 600.4 (2015) (defining an “institution of higher education” as being “in a State” but offering only broad guidelines for federal funding eligibility).

⁴⁶ See, e.g., 20 U.S.C. § 1161y (2012) (allowing the Secretary of Education to grant federal funding to state educational agencies to pay for their administrative expenses in participating in a Pell Grant demonstration program); 34 C.F.R. § 694.1 (2016) (stating the Secretary of Education will establish an annual state grant for a state’s participation in the GEAR UP program).

taxes imposed by states for such purpose tax deductible at the federal level.⁴⁷ In theory, states could use their taxing authority to fund any desired amount of higher education, and, in particular, could use it to generate the same \$10 million that arose in Table 2.1 from the federal government's tax preference granted to contributions.⁴⁸ For example, suppose the federal government wanted to pursue this approach with respect to the \$100 million income pool underlying my illustration.⁴⁹ If the affected states reacted by imposing a state income tax at a 10% flat rate on that income pool, and if the federal government allowed taxpayers to deduct their payment of that state income tax,⁵⁰ then the income pool would again generate \$37 million for the pursuit of all public goals. The state governments would control \$10 million, allocated to higher education, and the federal government would control the remaining \$27 million. In this case, shown in the second column of Table 2.2 below, the federal government's tax expenditure would piggyback off the states' direct expenditures, rather than off private donors' contributions.

Table 2.2	Grant of Federal Revenue to State to Fund Education	Deduction for State Income Tax used to Fund Education	Deduction for Contributions used to Fund Education
Non-Education Spending Con- trolled by Federal Government	\$27 million	\$27 million	\$27 million

⁴⁷ Cf. I.R.C. § 164 (2012) (codified as 26 U.S.C. § 164) (allowing taxpayers who itemize their below-the-line deductions to deduct state and local property taxes and to opt between deducting state and local sales taxes or state and local income taxes). But no specific federal income tax deduction currently exists for the payment of state taxes that are specifically earmarked for state educational funding. In spite of this, states fund postsecondary education. *See, e.g.*, COLO. REV. STAT. ANN. § 24-75-1001 (allocating funding for Colorado's higher education institutions out of Colorado's general revenue).

⁴⁸ *See supra* Table 2.1.

⁴⁹ *See supra* Part II.

⁵⁰ *See* I.R.C. § 164 (codified as 26 U.S.C. § 164).

Education Spending Controlled by Federal Government	\$3 million ⁵¹	\$0	\$0
Education Spending Delegated by Federal Government to States	\$0	\$3 million ⁵²	\$0
Education Spending Controlled by States	\$0	\$7 million	\$0
Education Spending Delegated by Federal Government to Donors	\$0	\$0	\$3 million ⁵³
Education Spending Controlled by Donors	\$0	\$0	\$7 million

Note that although the total amount spent on higher education is the same in the second and the third columns of Table 2.2, the two differ qualitatively. In the second column, where the federal government grants to the states the incentive to fund higher education by means of federally tax deductible state income taxes, the entire \$10 million ultimately devoted to higher education is extracted from the citizenry by means of taxes rather than voluntary contributions and is spent on education based on bureaucratic choices rather than individual choices. On the plus side, both the taxes imposed and the bureaucratic choices made presumably significantly reflect local

⁵¹ This \$3 million of federal funds is spent on higher education through a direct grant to the states.

⁵² The federal government spends this money indirectly through the states by allowing taxpayers a deduction on their federal income tax for amounts they pay toward their state taxes specifically earmarked for higher education.

⁵³ See *supra* note 42 (“The federal government would spend this money indirectly by allowing taxpayers a deduction on their federal income tax for amounts they contribute to universities.”).

(rather than merely national) educational preferences.⁵⁴ Nevertheless, to the extent that a voluntary component of education funding is deemed to be a virtue,⁵⁵ that virtue will have been lost.

III. WHY THE THEORETICAL DEFENSE FAILS WHEN APPLIED TO GIFTS TOWARDS ENDOWMENTS

Gifts to educational institutions tend to come in two flavors: smaller repeat gifts that become a revenue item in such institutions' annual budgets and larger one-time gifts that become part of such institutions' endowments.⁵⁶ I will concede for the sake of argument that one can justify tax preferences for the former on the grounds proffered above.⁵⁷ That is, the availability of a tax deduction for annual contributions to universities could spur giving and thus increase the aggregate amount of funds devoted to higher education.⁵⁸ Moreover, adding a private component to annual higher education funding could also lead to informational benefits, including more informed investing and improved monitoring, since annual givers have the ability—and the incentive—to modify their giving strategies in response to changing circumstances (such as, for example, a decline in the quality or quantity of educational services provided

⁵⁴ See, e.g., Justin R. Long, *Democratic Education and Local School Governance*, 50 WILLAMETTE L. REV. 401, 413–39 (2014) (reviewing several arguments in favor of local control for schools, including the notion that local control affords choosy parents a diversity of schooling options in a real estate marketplace).

⁵⁵ See Mark P. Gergen, *The Case for Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1409 (1988) (“Donors may prefer a system in which charities are underfunded, and they pay a disproportionate share of the cost, because of the pleasure (and influence) they get from a voluntary system.”) (internal parentheses in original).

⁵⁶ See, e.g., *How Endowments Work*, EMORY UNIV. FIN. DIV., https://www.finance.emory.edu/home/accounting_svcs/Endowment%20and%20Investment/index_accounting_how_endowments_work.html (last visited Mar. 11, 2017) (describing how a donor can give to Emory University by establishing an endowment); *Planned Gifts*, EMORY UNIV. FIN. DIV., https://www.finance.emory.edu/home/accounting_svcs/Endowment%20and%20Investment/index_accounting_planned_giving.html (last visited Mar. 11, 2017) (describing common forms of gift-giving to Emory University other than by establishing an endowment).

⁵⁷ See *supra* Part II.

⁵⁸ See Schizer, *supra* note 30, at 229 (“[A] familiar rationale for subsidizing charitable contributions is to persuade donors to be more generous.”).

by a particular educational institution).⁵⁹ But one cannot similarly justify the availability of a tax deduction for larger one-time gifts to endowments.

To demonstrate this point, I need to make a slight modification to the previous illustration.⁶⁰ So far, I imposed no particular structure on the initial \$100 million income pool. Now, I will assume that such income pool is earned entirely by a very small number of very wealthy individuals. This assumption comports with the reality that gifts to endowments tend to be far fewer in number than annual gifts, but also tend to be much larger on a per-gift basis.⁶¹ In other words, endowments are funded primarily by the very wealthy.

A gift to an educational endowment does not produce an immediate expenditure on higher education.⁶² Rather, the endowment maintains control of the funds received, invests them as it sees fit, and annually distributes some generally fixed, relatively small percentage of its assets to its host institution.⁶³ This arrangement is designed to maximize the likelihood that the funds last in perpetuity.⁶⁴ It is only the annual distributions that actually fund higher education.⁶⁵ As a preliminary matter, this arrangement might lead one to

⁵⁹ See *id.* at 229–30, 256 (“Since [donors] are contributing their own money, donors have the incentive to assess whether their gifts are having a positive impact.”).

⁶⁰ See *supra* Part II.

⁶¹ See, e.g., Kaitlin Mulhere, *Deep-Pocket Donors*, INSIDE HIGHER ED (Jan. 28, 2015), <https://www.insidehighered.com/news/2015/01/28/2014-record-year-higher-ed-donations> (“The University of Texas at Austin . . . placed seventh [among schools of total funds raised in 2014] thanks to a nearly \$217 million art gift that accounted for more than 40 percent of the university’s total.”). See also, e.g., Press Release, Council for Aid to Educ., Colleges and Universities Raise \$37.45 Billion in 2014: Harvard Raises \$1.16 Billion (Jan. 28, 2015), <http://cae.org/images/uploads/pdf/VSE-2014-Press-Release.pdf>.

⁶² See, e.g., Albert Phung, *How Do University Endowments Work?*, INVESTOPEDIA, <http://www.investopedia.com/ask/answers/06/universityendowment.asp> (last visited Mar. 11, 2017) (“The sole intention of the endowment is to invest it . . .”).

⁶³ See, e.g., *id.*

⁶⁴ See, e.g., *How Endowments Work*, *supra* note 56 (“[T]he University is unable to spend the principal of the endowment but it is able to spend all or a portion of the income that is generated through the investment of the gift.”).

⁶⁵ See, e.g., Phung, *supra* note 62 (describing how donors can restrict how investment income is spent and how universities have freedom to make such decisions in the absence of such restrictions).

ask: Is it even the case that a \$10 million gift to a university endowment in any relevant sense purchases \$10 million in educational expenditures?

The answer is not necessarily. Importantly, any endowment requires a bureaucratic infrastructure, including investment professionals, accountants, and the like.⁶⁶ Such an infrastructure does not come cheap. For purposes of illustration, assume that the endowment's direct costs amount to 1% of assets annually.⁶⁷ On top of these direct costs, the endowment is likely to hire outside managers, such as hedge funds, private equity funds, and venture capital funds, to manage a part of its assets.⁶⁸ For purposes of illustration, assume that 20% of the endowment's assets are managed in this manner.⁶⁹

⁶⁶ A number of educational institutions with large endowments have established in-house "investment management companies" to manage their investments. *See, e.g.*, HARVARD MGMT. CO., <http://www.hmc.harvard.edu/investment-management/index.html> (last visited Jan. 30, 2017); STANFORD MGMT. CO., <http://www.smc.stanford.edu/> (last visited Mar. 11, 2017); YALE INV. OFF., <http://investments.yale.edu/> (last visited Mar. 11, 2017).

⁶⁷ *Cf.* Memorandum from the Office of Fed. Relations, Harvard Univ., to The Honorable Orrin Hatch, Chairman, Senate Comm. on Finance, United States Senate, The Honorable Kevin Brady, Chairman, House Comm. on Ways and Means, United States House of Representatives, and The Honorable Peter Roskam, Chairman, Oversight Subcomm., House Comm. on Ways and Means, United States House of Representatives 9 (Mar. 31, 2016) *available at* http://www.harvard.edu/sites/default/files/content/20160401_harvard_congressional_report.pdf (in a letter to Congress defending the tax exempt status of Harvard University's endowment, Harvard University President Drew Faust stated that the annual cost of Harvard Management Company, Inc., is around .75% of assets under management, and noted further that such cost was well below the 2% external management would generally cost).

⁶⁸ *Cf.* JANE L. MENDILLO, HARVARD MGMT. CO., SEPTEMBER 2014 ANNUAL ENDOWMENT REPORT, MESSAGE FROM THE CEO 6 (2014) *available at* http://www.hmc.harvard.edu/docs/Final_Annual_Report_2014.pdf (in its Annual Endowment Report for FY 2014, the Harvard Management Company, Inc. estimated that by managing its investments partially-internally (a so-called "hybrid" structure), Harvard University had saved approximately \$2.0 billion between 1994 and 2014, as compared to the cost of an entirely externally managed portfolio).

⁶⁹ *Cf.* HEDGE CLIPPERS, ENDANGERED ENDOWMENTS: HOW HEDGE FUNDS ARE BANKRUPTING HIGHER EDUCATION, HEDGE PAPERS NO. 25 (Feb. 7, 2016) *available at* <http://hedgeclippers.org/wp-content/uploads/2016/02/HP25.pdf> (estimating that over \$100 billion out of \$500 billion total university endowment funds were invested in hedge funds alone). Noted, however, that hedge funds are not the only type of externally managed fund.

And assume that the chosen hedge funds, private equity funds, and venture capital funds impose a 2-and-20 fee structure on the assets they manage, as is indeed standard industry practice: thus, 2% of assets plus 20% of profits remain with the managers of the various funds.⁷⁰ Finally, assume that notwithstanding the heroic efforts of the many investment professionals, the endowment's investments merely earn the fair expected return that reflects the risk of its investments.⁷¹ For purposes of illustration, I assume such return is 10%.

Table 3 illustrates the workings of these various fees in the year after the endowment receives its \$10 million gift, subject to the additional proviso that the endowment at the end of the year pays out 4% to its initial assets to its host university:

Table 3	Assets Managed Directly	Assets Managed by Third Persons
Beginning of Year Allocation	\$8,000,000	\$2,000,000
Investment Return (10%)	\$800,000	\$200,000
Direct Costs	(\$80,000)	

⁷⁰ See, e.g., Janet Lorin, *Small Endowments Lose Money on Hedge Funds, Trailing Big Schools*, BLOOMBERG (Feb. 8, 2016, 10:00 AM), <http://www.bloomberg.com/news/articles/2016-02-08/small-endowments-lose-money-on-hedge-funds-trailing-big-schools> (hedge funds received \$2.5 billion in fees from university endowments in 2015, which amounted to over half of the total earnings from the endowments' investments). Cf. Victor Fleischer, *Stop Universities From Hoarding Money*, N.Y. TIMES (Aug. 19, 2015), <http://www.nytimes.com/2015/08/19/opinion/stop-universities-from-hoarding-money.html> (estimating that Harvard University spent \$362 million and Yale University spent \$480 million in 2014 on private equity management fees).

⁷¹ See BEN JOHNSON, MORNINGSTAR'S ACTIVE/PASSIVE BAROMETER: A NEW YARDSTICK FOR AN OLD DEBATE, MORNINGSTAR 1–2 (June 25, 2015), available at <http://corporate.morningstar.com/US/documents/ResearchPapers/MorningstarActive-PassiveBarometerJune2015.pdf> (measuring “active managers’ success relative to the actual, net-of-fee performance of passive funds, rather than an index which isn’t investable” and finding “that actively managed funds have generally underperformed their passive counterparts, especially over longer time horizons, and experienced higher mortality rates . . .”).

2% Fund Management Fee		(\$40,000)
20% Carried Interest		(\$40,000)
Net Profit	\$840,000	
4% Payout to University	(\$400,000)	
Addition to Endowment Capital	\$440,000	
End of Year Allocation (Rebalanced)	\$8,352,000	\$2,088,000

The story set out in Table 3 repeats itself in subsequent years. In the second year, the endowment's payout to the university would increase from \$400,000 to \$417,600, and in the third year it would increase further to \$435,974. The net present value of all future payouts, discounted at the 10% rate that reflects the risk of the endowment's investments, is \$7.143 million, or *considerably less* than the initial \$10 million contributed to the endowment.⁷² What has happened to the amount originally contributed for educational purposes is that a (large) fraction has been diverted to support investment professionals and infrastructure. Presumably such diversion reflects neither the wishes of the donors nor the objectives embodied in the

⁷² This result is easy to derive and generalize. Let E be the amount contributed to the endowment (\$10 million in the illustration). Let r be the expected rate of return on the endowment's investments that appropriately reflects the risk of such investments (10% in the illustration). Let c be the percentage of assets paid to various investment advisors (1% in direct costs for all endowment assets and 2-and-20 paid to fund managers, for an aggregate 1.6% in the illustration). Finally, let p be the payout rate to the university (4% in the illustration). Under these predicates, the endowment's assets and hence the university's payouts grow at an annual rate of $(r - c - p)$: the former at the beginning of a hypothetical year n being $(1 + r - c - p)^{(n-1)} * E$ and the latter (paid at the end of year n) consequently being $p * (1 + r - c - p)^{(n-1)} * E$. The net present value of the series of payouts, discounted at the appropriate discount rate of r , is $p * E / (c + p)$. Thus, in the illustration, where p is 4% and c is effectively 1.6%, only 4/5.6 of the amount contributed to the endowment ultimately redounds to the benefit of the university; the remaining 1.6/5.6 redounds to the benefit of the various investment professionals who directly and indirectly manage the endowment's assets.

charitable contribution deduction.⁷³ Table 2.3 modifies Table 2.2 to reflect the leakage caused by investment expenses.⁷⁴

Table 2.3	Grant of Federal Revenue to State to Fund Education	Deduction for State Income Tax used to Fund Education	Deduction for Contributions used to Fund Education
Current Non- Education Spend- ing Controlled by Federal Government	\$27 million	\$27 million	\$27 million
Current Education Spending Con- trolled by Federal Government	\$3 million ⁷⁵	\$0	\$0
Current Education Spending Delegated by Federal	\$0	\$3 million ⁷⁶	\$0

⁷³ This last point may be a slight overstatement, inasmuch as it is not entirely clear what all objectives are embodied in the charitable contribution deduction. Thus, under the Internal Revenue Code, tax-favorable treatment of education includes almost anything remotely connected with education. *See, e.g.*, John D. Colombo, *Why Is Harvard Tax-Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions)*, 35 ARIZ. L. REV. 841, 857 (1993) (describing how federal and state attempts to limit the tax exemption for educational institutions have failed). Under this standard-less standard, it is difficult to argue that expenditures on lavish physical plant or bloated administrative staffs with even more bloated compensation are not expenditures "on education." *But see infra* Part IV.

⁷⁴ Nothing in the arithmetic set forth in note 69 hinges on any particular payout rate (or cost structure). Thus, if the payout rate doubled to 8% (as it would if Congress adopted the recommendations of Victor Fleischer, *supra* note 70) and the costs of managing endowments fell to 1% (as they might if all management were in-house), leakage of the donor's gift would fall to $1/(1 + 8)$ or 11% of the gift. But even under those altered extremely favorable facts, fully \$1.1 million or the original \$10 million gift would never produce any higher education benefits.

⁷⁵ *See supra* note 51.

⁷⁶ *See supra* note 52.

Government to States			
Current Education Spending Controlled by States	\$0	\$7 million	\$0
NPV of Future Education Spending Delegated by Federal Government to Donors	\$0	\$0	\$2.143 million ⁷⁷
NPV of Future Education Spending Controlled by Donors	\$0	\$0	\$5 million ⁷⁸

Now that I have established that a gift to a university endowment does not in general provide an expenditure on higher education in an amount equal to the gift's face amount,⁷⁹ let me return to the alleged benefits of funding higher education by means of tax-deductible gifts to endowments to see whether such benefits can plausibly compensate for investment expense leakage. The short answer is that they cannot. Indeed, one can argue that none of the alleged benefits really exist.

I can quickly dispose of the third alleged benefit: donor monitoring.⁸⁰ Endowment gifts are generally one-time gifts that provide an irrevocable stream of future revenue to a chosen institution.⁸¹ Once the gift is made, the donor has essentially no recourse even if the chosen institution grossly mismanages either the gift or the

⁷⁷ This is 30% of the \$7.143 million net present value of future education expenditures referenced in the text. *See supra* note 42.

⁷⁸ This is 70% of the \$7.143 million net present value of future education expenditures referenced in the text.

⁷⁹ The prerequisite for a gift to provide an expenditure on higher education in an amount equal to its face amount is that the endowment is able to generate excess returns from its investment management that more than compensate for the cost of such management. As noted in *supra* note 64, this holy grail is ex ante impossible to achieve.

⁸⁰ *See supra* notes 37–38 and accompanying text.

⁸¹ *See, e.g.,* Phung, *supra* note 62.

stream of revenue generated by the gift.⁸² Accordingly, a donor has little incentive to monitor the institution after the gift has been made.⁸³

I can also reject the second alleged benefit, the ability to piggyback on informed societal preferences.⁸⁴ The basis for this rejection is that such piggybacking is antithetical to democratic principles.⁸⁵ The federal government, through elected officials, represents all people within its taxing jurisdiction, however imperfectly.⁸⁶ Thus, any expenditure made by the federal government presumptively reflects the will of all 321 million of us.⁸⁷ And state governments, in turn, represent all people within their taxing jurisdictions.⁸⁸ Again,

⁸² See Schizer, *supra* note 30, at 263 (“Although conditions can be placed on how the endowment is used, it will be difficult for the donor to impose a condition relating to the quality of the effort, since the condition is hard to specify, let alone to enforce.”).

⁸³ See *id.* (“If [donors] are willing to surrender control [by giving an endowment], they must have particular confidence in the nonprofit’s management.”).

⁸⁴ See *supra* notes 39, 41 and accompanying text.

⁸⁵ See Schizer, *supra* note 30, at 247 (“[D]onors may not adequately represent the preferences of society as a whole, so that there is allocation error when the wrong projects are pursued.”). *But see* *Az. Christian Sch. Tuition Org. v. Winn*, 563 U.S. 125, 142 (2011) (“Yet tax credits and governmental expenditures do not both implicate individual taxpayers in sectarian activities When the government declines to impose a tax . . . there is no such connection between dissenting taxpayer and alleged establishment.”).

⁸⁶ *Cf.* Nancy C. Staudt, *Taxation Without Representation*, 55 TAX L. REV. 555, 571–78, 595–97 (2002) (arguing that deductions inappropriately serve as selective voting mechanisms by which taxpayers can divert otherwise public funds for their own purposes).

⁸⁷ *Cf. id.*

⁸⁸ See, e.g., U.S. CONST. amend. XIV, § 1 (“No state shall make or enforce any law which shall . . . deny to any person within its jurisdiction the equal protection of the laws.”). *Cf.* *Saenz v. Roe*, 526 U.S. 489, 503–04 (1999) (“A citizen of the United States has a perfect constitutional right to go to and reside in any State he chooses, and to claim citizenship therein, and an equality of rights with every other citizen.” (quoting *The Slaughter–House Cases*, 83 U.S. 36, 112–13 (1872))) (emphasis added); *Bd. of Educ. of Kiryas Joel Village Sch. Dist. v. Grumet*, 512 U.S. 687, 728–29 (1994) (Kennedy, J., concurring in the judgment) (quoting *Wright v. Rockefeller*, 376 U.S. 52, 67 (1964) (Douglas, J., dissenting)) (“When racial or religious lines are drawn by the State, the multiracial, multireligious communities that our Constitution seeks to weld together as one become separatist Since that system is at war with the democratic ideal, it should find no footing here.”) (internal quotation marks omitted). *But cf.* *Walz v. Tax*

any expenditure made by such governments presumptively reflects the will of all people they represent.⁸⁹ On the other hand, an endowment gift made by a single donor reflects the will of only one generally wealthy—and therefore not terribly representative—individual. If such an individual merely controlled the ultimate educational use of his or her “excess generosity,” i.e., the incremental \$4.143 million in my illustration,⁹⁰ there would be little cause to object; absent the charitable contribution such amounts presumably would not be spent on higher education at all. But such individual also controls the ultimate educational use of the \$3 million in the illustration that the federal government intends to spend on higher education in any event. However inefficient the federal government may be in choosing how to direct such spending, such inefficiency should be tolerated because the resulting spending will necessarily be significantly more reflective of the public will than spending directed by any individual donor would be.⁹¹

Comm’n of N.Y., 397 U.S. 664, 691 (1969) (Brennan, J., concurring) (“Tax exemptions, accordingly, constitute mere passive state involvement with religion and not the affirmative involvement characteristic of outright governmental subsidy.”).

⁸⁹ See, e.g., *Az. Christian Sch.*, 563 U.S. at 142 (“A dissenter whose tax dollars are ‘extracted and spent’ knows that he has in some small measure been made to contribute to an establishment in violation of conscience.”); *id.* at 148 (Kagan, J., dissenting) (“Taxpayers who oppose state aid of religion have equal reason to protest whether that aid flows from the one form of subsidy or the other. Either way, the government has financed the religious activity. And so either way, taxpayers should be able to challenge the subsidy.”).

⁹⁰ This “excess generosity” in my illustration is the excess of the \$7.143 million spent on higher education over the \$3 million that would have been spent directly by the federal government in lieu of establishing the charitable deduction mechanism. See *supra* Table 2.3.

⁹¹ See Schizer, *supra* note 30, at 244–48 (noting some of the problems with using tax preferences for charities as an allocative guide). See also Rick Seltzer, *Strings Attached*, INSIDE HIGHER ED (Aug. 31, 2016), <https://www.insidehighered.com/news/2016/08/31/wayne-state-donor-agreement-goes-under-microscope> (giving an illustration of a donor’s arguable overreach in attempting to control a university’s use of an endowment gift). But see Brian Galle, *The Role of Charity in a Federal System*, 53 WM. & MARY L. REV. 777, 790–91 (2012) (discussing Burton Weisbrod’s Median Voter Theory and its application to charitable subsidies, stating that “[s]ubsidies for charity thus allow voters who want more of the good to surmount the free rider barrier.”).

But even after dismissing the latter two alleged benefits of allowing deductions for contributions to university endowments, the first alleged benefit appears to retain its full force: in the illustration the deduction has led to \$4.143 million of completely voluntary incremental spending on higher education.⁹² Surely the benefits flowing from the mere availability of these additional funds should more than compensate for the loss of the federal government's control over \$3 million of education spending.⁹³ Put differently, is it not beyond a doubt that the public benefit generated by \$7.143 million of public-spirited spending allocated according to the whims of a few wealthy and generous individuals must exceed the public benefit generated by \$3 million of spending allocated according to the whims of the federal government?

It may be beyond a doubt, but the premise is highly debatable. Undoubtedly, some donors give until it hurts.⁹⁴ But many gifts that fund endowments are surely made by individuals who have amassed such considerable wealth that they do not envision any alternative lifetime or even testamentary need for the funds they donate.⁹⁵ Thus, if such donors did not make their gifts, they would instead save and invest and generate additional investment income, which they would also save and invest, ad infinitum. However, each year, the federal government would take a slice of the additional income via taxation

⁹² See, e.g., Schizer, *supra* note 30, at 229. See also Table 2.3.

⁹³ Or, in the alternative, the benefits from the additional funds should surely more than compensate for the loss of the federal government's control over \$3 million of general spending.

⁹⁴ See, e.g., Adam Lashinsky, *Apple's Tim Cook Leads Different*, FORTUNE (Mar. 26, 2015, 7:40 AM), <http://fortune.com/2015/03/26/tim-cook/> ("To Cook, changing the world always has been higher on Apple's agenda than making money. He plans to give away all his wealth, after providing for the college education of his 10-year-old nephew.").

⁹⁵ See, e.g., Douglas Belkin, *Harvard Gets Largest-Ever Donation; Family of Hong Kong-Born Investor Gives \$350 Million to His Alma Mater*, WALL ST. J. (Sept. 8, 2014), <http://www.wsj.com/articles/harvard-gets-largest-ever-donation-1410148865> (describing how Gerald Chan, a Harvard alum, donated \$350 million to the school); Jeff Blumenthal, *Local Law School Gets Another Major Gift*, PHILA. BUS. J. (Mar. 19, 2015, 12:58 PM), <http://www.bizjournals.com/philadelphia/news/2015/03/19/local-law-school-gets-another-major-gift.html?page=all> (describing how John F. Scarpa, founder and former co-chairman of American Cellular Network Corporation, gave Villanova University School of Law \$5 million in donations).

and direct the spending of such slice to satisfy public goals. It turns out that, over time, the entire amount that would have been gifted will ultimately be taxed away and thus be dedicated to the service of public goals. While this sounds like confiscatory taxation and may indeed be a justification for such taxation, it is in fact nothing more than a formalization of the reality that if a taxpayer has more wealth than he or she has any reasonable hope of ever consuming, the excess will in one way or another—whether by contribution or by taxation—ultimately be dedicated to public goals.

To illustrate this point, assume (without any loss of generality) that the hypothetical \$10 million income pool belongs to a single wealthy donor. If the donor makes a contribution to a university endowment, the endowment receives an additional \$10 million, the federal government loses \$3 million, and spending on higher education appears to increase by a net of \$7 million (although as demonstrated above in fact only increases by a net of \$4.143 million).⁹⁶ On the other hand, if the donor does not make a contribution, the federal government gets \$3 million of immediate tax revenue and the donor has an incremental \$7 million to save and invest. Suppose that investments earn a pre-tax expected rate of return of 10% and that such earnings are taxed at the same 30% rate as the donor's remaining income.⁹⁷ Then, in the first year after not making a donation, the donor earns \$700,000 more than he or she would otherwise have earned and pays \$210,000 more in federal income tax than he or she would otherwise have paid. After the dust settles on such earnings and taxes, the donor's incremental investment pool increases to \$7.49 million. And this process repeats itself in the next year, and the next, and so on.

The first important thing to note is that the federal government now has a revenue stream that it would not have had if the donor had made his initial contribution. Stated differently, the initial contribution did not merely deprive the federal government of \$3 million of immediate tax revenue, it also deprived the federal government of \$210,000 of tax revenue in the following year, and so on in perpetuity. The second important thing to note is that the only leakage from the income pool is to the federal government in the form of taxes. If this remains true year in and year out, as it will if the

⁹⁶ See *supra* Table 2.1 and Table 2.3.

⁹⁷ These rates are for purposes of illustration only and do not affect the result.

donor really has no alternative need of or use for the funds, then the net present value of revenues that eventually will be siphoned off by the federal government will indeed be \$10 million. Thus, the entire pool will be spent *by the federal government* in pursuit of public goals.⁹⁸ Table 2.4 updates Table 2.3 to reflect this reality: allowing a tax deduction for a contribution to an endowment does not result in *any* additional expenditure on the pursuit of public goals.

⁹⁸ This result is easy to derive and generalize; it is arithmetically the same as the result that was derived in *supra* note 72. Let D be the amount otherwise contributed to the endowment (\$10 million in the illustration). Let r be the expected pre-tax rate of return on the invested assets (10% in the illustration). Let t be the tax rate imposed on the pre-tax return (30% in the illustration), in which case $(1-t)r$ is the after-tax rate or return (7% in the illustration). Note that the initial amount of invested assets is $(1-t)D$ (\$7 million in the illustration), since tD of tax would be collected in the absence of a contribution (\$3 million in the illustration). Thus, $r(1-t)D$ of pre-tax income will be generated in the first year (\$700,000 in the illustration), which in turn leads to a tax payment of $t r (1-t)D$ (\$210,000 in the illustration). At the end of the first year, the amount of invested assets grows to $(1 + (1-t)r)(1-t)D$ (\$7.49 million in the illustration). In the n th year, the invested assets will earn pre-tax income of $r(1 + (1-t)r)^{n-1}(1-t)D$, which will yield a tax payment of $t r (1 + (1-t)r)^{n-1}(1-t)D$. Moreover, at the end of the n th year, the amount of invested assets will grow to $(1 + (1-t)r)^n(1-t)D$. The federal government's revenue stream is as follows: it initially collects tD ; it then collects $t r (1-t)D$ at the end of the first year; and it collects $t r (1 + (1-t)r)^{n-1}(1-t)D$ at the end of the year n . When this revenue stream is discounted at the appropriate discount rate of r , the initial tax payment has a net present value of tD , the year 1 tax payment has a net present value of $t r (1-t)D/(1+r)$, and the year n tax payment has a net present value of $t r (1 + (1-t)r)^{n-1}(1-t)D/(1+r)^n$. And the sum of the net present value of all such tax payments turns out to be D ! Thus, to repeat, if no part of the otherwise contributed and perpetually reinvested assets is ever diverted to private consumption, the federal government will eventually effectively confiscate all such assets.

Table 2.4 (Potential Cash Contribution)	Grant of Federal Revenue to State to Fund Education	Deduction for Contributions used to Fund Education
Current Non-Education Spending Controlled by Federal Government	\$27 million	\$27 million
Current Education Spending Controlled by Federal Government	\$3 million	\$0
NPV of Future Education and Non-Education Spending Con- trolled by Federal Government	\$7 million	\$0
NPV of Future Education Spending Delegated by Federal Government to Donors	\$0	\$2.143 million
NPV of Future Education Spending Controlled by Donors	\$0	\$5 million

To summarize, the effects of granting (versus not granting) a tax deduction to a donor who contributes to an educational endowment manifest themselves along three dimensions: (1) how much is actually spent in pursuit of higher education and/or in pursuit of other public goals, (2) when such amounts are spent, and (3) who controls how such amounts are spent. Under the assumptions illustrated in Table 2.4, if no charitable contribution deduction exists to induce a \$10 million cash gift to an endowment, the federal government will receive \$30 million of tax revenue today, will receive an additional \$7 million (in terms of net present value) in subsequent years, and will control the spending of all such revenue. With respect to the future revenue, the federal government retains the flexibility to allocate such revenue to public goals, including but not limited to higher education, as such goals evolve over time.⁹⁹ On the other

⁹⁹ Cf. Yair Listokin & David M. Schizer, *I Like to Pay Taxes: Taxpayer Support for Government Spending and the Efficiency of the Tax System*, 66 TAX L.

hand, if a charitable contribution deduction induces a \$10 million cash gift to an educational endowment, the federal government will receive \$27 million of tax revenue today, public goals in the form of education will receive \$7.143 million (in terms of net present value) in subsequent years, and all such \$7.143 million will be spent according to a non-public administrator's interpretation of the individual donor's wishes.¹⁰⁰ In this case, the \$7.143 million of future spending will be restricted to higher education at a single institution, even if higher education funding in general ceases to be a recognized public goal or if higher education funding of the specified institution in particular ceases to be a desirable goal. Thus, in the context of a cash gift to an educational endowment, it is trivial to weigh the costs and benefits of the charitable contribution deduction: there are *no* benefits! Accordingly, there is no theoretical justification for granting such tax deduction.

And as can be seen in Table 2.5, the picture only gets worse if the donor's contribution is made in the form of appreciated capital gain property.¹⁰¹

REV. 179, 198 (2013) (“[I]n requiring particular taxes to fund only specified programs, we lose the flexibility to redirect tax dollars as conditions change. All else being equal, the government should want this flexibility.”).

¹⁰⁰ See, e.g., Phung, *supra* note 62 (providing an overview of how endowments function).

¹⁰¹ Recall, *supra* note 33 and Table 1.2, the possibility that the income from which the deductible contribution would be made consisted entirely of unrealized capital gain. If so, then in the absence of a contribution, the foregoing argument, *supra* text accompanying notes 94-98, leads to the result that the federal government would eventually obtain tax revenue with a net present value of \$10 million from the \$10 million that would have been contributed to the endowment. (This is true even in the presence of the realization doctrine, which might lead the taxpayer to defer the realization of the gain with respect to some or all of the \$10 million he would otherwise have contributed. See, e.g., DANIEL Q. POSIN & DONALD B. TOBIN, PRINCIPLES OF FEDERAL INCOME TAXATION OF INDIVIDUALS 152-66 (7th ed. 2005) (briefly discussing the realization requirement for federal income taxation); Christopher H. Hanna, *Demystifying Tax Deferral*, 52 SMU L. REV. 383, 411-12 (1999) (explaining the issue of unrealized appreciation through an example)).

Table 2.5 (Potential Property Contribution)	Grant of Federal Revenue to State to Fund Education	Deduction for Contributions used to Fund Education
Current Non-Education Spending Controlled by Federal Government	\$13.5 million	\$10.5 million
Current Education Spending Controlled by Federal Government	\$1.5 million	\$0
NPV of Future Education and Non-Education Spending Controlled by Federal Government	\$8.5 million	\$0
NPV of Future Education Spending Delegated by Federal Government to Donors	\$0	\$3.214 million ¹⁰²
NPV of Future Education Spending Controlled by Do- nors	\$0	\$3.929 million ¹⁰³

In Table 2.5, if no charitable contribution deduction exists to induce a \$10 million property gift to an endowment, the federal government will receive \$15 million of tax revenue today, will receive an additional \$8.5 million (in terms of net present value) in subsequent years, and will control the spending of all such revenue. With respect to the future revenue, the federal government will retain the flexibility to allocate such revenue to public goals, including but not limited to higher education, as such goals evolve over time. On the

¹⁰² As the contribution costs the federal government \$4.5 million of revenue, the federal government's share of the gift is effectively 45%. As set forth in *supra* note 72, the entire \$10 million gift only leads to \$7.143 million net present value of future spending on education. The \$3.214 million figure in the table is 45% of \$7.143 million.

¹⁰³ As the contribution costs the federal government \$4.5 million of revenue, the donor's share of the gift is effectively 55%. As set forth in *supra* note 72, the entire \$10 million gift only leads to \$7.143 million net present value of future spending on education. The \$3.929 million figure in the table is 55% of \$7.143 million.

other hand, if a charitable contribution deduction induces a \$10 million property gift to an educational endowment, then exactly as in the case of a cash gift (see Table 2.4), the federal government will receive less tax revenue today (\$10.5 million instead of \$15 million), while public goals in the form of education will receive \$7.143 million (in terms of net present value) in subsequent years, all of which will be spent according to a non-public administrator's interpretation of the individual donor's wishes. Moreover, the \$7.143 million of future spending will be restricted to higher education at a single institution, even if higher education funding in general ceases to be a recognized public goal or if higher education funding of the specified institution in particular ceases to be a desirable goal. Thus, as was the case with respect to a cash gift, there is no theoretical justification for granting a tax deduction for a property gift to an educational endowment.

IV. THE EVIDENCE

Is there any evidence that would-be public funds diverted to educational endowments by the grant of tax preferences efficiently satisfy public goals? In particular, do such endowments somehow lead to the societal purchase of more or better education? I cannot answer that question with respect to the bare existence of endowments,¹⁰⁴

¹⁰⁴ Relevant literature contains one thorough attempt to divine possible reasons behind the existence of university endowments. *See generally* Henry Hansmann, *Why Do Universities Have Endowments?*, 19 J. LEGAL STUD. 3 (1990). Hansmann's possible reasons include the following: (1) endowments are a means to provide intergenerational equity; (2) they serve as a financial buffer during periods of adversity; (3) they insure the long-run survival of reputational capital; (4) they protect intellectual freedom; and (5) they allow current generations to pass on their values. *See id.* at 14, 19, 27, 29, 32. But Hansmann ultimately concludes that none of these reasons explain actual university practice with respect to their endowments. *See id.* at 39. *See also* Peter Conti-Brown, Note, *Scarcity Amidst Wealth: The Law, Finance, and Culture of Elite University Endowments in Financial Crisis*, 63 STAN. L. REV. 699, 705–15 (2011) (arguing that the financial buffer rationale is not supported by university behavior in the face of the recent financial crisis).

Even if Hansmann had found university practice consistent with one or more of his proffered reasons for the existence of endowments, this consistency would not justify granting endowments tax-preferential treatment. Such treatment—which, as I have demonstrated, *supra* Part III, is equivalent to diverting public funds to

but I will attempt an answer with respect to their growth. But if an increase in the size of endowments does not lead to more or better education, then the actual existence of endowments cannot do so either.¹⁰⁵

I limit my attention to the top-twenty private universities, as ranked by U.S. News and World Report.¹⁰⁶ I do this mostly to keep the data set manageable, but also because these universities control the lion's share of endowed funds.¹⁰⁷ I further limit my attention to

endowments—can only be justified if endowments serve *public goals*. Institutional survival (which is essentially what three of Hansmann's reasons amount to) is not a public goal. See Hansmann, *supra* note 104, at 19, 27, 32. And while intergenerational equity may or may not be a public goal, it is at best a subsidiary one that presupposes that endowment dollars are actually purchasing some more fundamental public goal (for example, improving the quality of the education provided to members of various generations). See *id.* at 14. That leaves only the encouragement of intellectual freedom as a possible stand-alone public goal. See *id.* at 29. But that goal is problematic as well, unless it leads to better education. First and foremost, the tenure system—rather than the existence of educational endowments—is the primary defender of intellectual freedom, at least in a qualitative sense—that is, with respect to what is said. See, e.g., *Grimes v. E. Ill. Univ.*, 710 F.2d 386, 388 (7th Cir. 1983) (“The purpose of tenure is to protect academic freedom—the freedom to teach and write without fear of retribution for expressing heterodox ideas . . .”). See also AM. ASS'N UNIV. PROFESSORS, 1940 STATEMENT OF PRINCIPLES ON ACADEMIC FREEDOM AND TENURE WITH 1970 INTERPRETIVE COMMENTS 14 (1940), available at <https://www.aaup.org/file/1940%20Statement.pdf> (last visited Mar. 11, 2017). Moreover, that defending intellectual freedom in a quantitative sense—that is, with respect to how much of it is said—is such a desirable stand-alone goal that it should be subsidized with public funds is unclear. To wit, even the most zealous defender of the academy would be hard-pressed to argue that an insufficient amount of “scholarship” is currently being produced by America's universities. See, e.g., Arif E. Jinha, *Article 50 Million: An Estimate of the Number of Scholarly Articles in Existence*, 23 LEARNED PUB. 258, 261 (2010) (estimating the total number of scholarly articles in existence to be almost 50 million by the end of 2008).

¹⁰⁵ This is an arithmetic point. If increased endowment size produces no demonstrable benefit, then decreased size would not produce any demonstrable detriment, and in the limit, decreased size would result in the disappearance of endowments altogether.

¹⁰⁶ *National Universities Rankings*, U.S. NEWS & WORLD REP., 2015, at 74.

¹⁰⁷ See *U.S. and Canadian Institutions Listed by Fiscal Year (FY) 2015 Endowment Market Value and Change in Endowment Market Value from FY2014 to FY2015*, NAT'L ASS'N OF C. & UNIV. BUS. OFFICERS, http://www.nacubo.org/Documents/EndowmentFiles/2015_NCSE_Endowment_Market_Values.pdf (last visited Mar. 11, 2017) [*hereinafter* NACUBO, *FY 2015 Endowment Market*

the years between 1990 and 2015, since this period witnessed a meteoric increase in the size of endowments and since other data are also readily available for this period.¹⁰⁸ As shown in Table 4, during these two-and-a-half decades, the average size of these private universities' endowments increased 735% from \$1.244 billion to \$10.378 billion, or at an annual compounded rate of 8.86%. By the end of the period, these endowments controlled \$218 billion of what would otherwise have been the public's money.¹⁰⁹

Table 4¹¹⁰

Rank	School	1990 Endowment	2015 Endowment
1	Princeton University	\$2,527,140,000	\$22,723,473,000
2	Harvard University	\$4,653,229,000	\$36,448,817,000
3	Yale University	\$2,570,892,000	\$25,572,100,000
4	Columbia University	\$1,494,938,000	\$9,639,065,000
4	Stanford University	\$2,053,128,000	\$22,222,957,000

Value]; Chris Isidore, *Rich Universities Are Getting Richer*, CNN MONEY (Apr. 18, 2015, 7:08 PM), <http://money.cnn.com/2015/04/16/pf/college/richest-universities/>.

¹⁰⁸ Compare NACUBO, *FY 2015 Endowment Market Value*, *supra* note 107 (listing Harvard University as having nearly \$36 billion in endowment assets in 2014), with *Institutions Ranked by 1990 Market Value of Endowment Assets*, NAT'L ASS'N OF C. & UNIV. BUS. OFFICERS 23, http://www.nacubo.org/Research/NACUBO-Commonfund_Study_of_Endowments/Public_NCSE_Tables/Total_Market_Value_of_Endowments.html (last visited Mar. 11, 2017) [*hereinafter* NACUBO, *FY 1990 Endowment Market Value*] (accessed through "1990 Total Market Values" link) (listing Harvard University as having over \$4.6 billion of endowment assets in 1990).

¹⁰⁹ See *infra* Table 4.

¹¹⁰ Table 4 combines statistics retrieved from the NACUBO-Commonfund Study of Endowment Results with U.S. News and World Report university rankings, with public universities removed. See NACUBO, *FY 1990 Endowment Market Value*, *supra* note 108; NACUBO, *FY 2015 Endowment Market Value*, *supra* note 107; *National Universities Rankings*, *supra* note 106.

4	University of Chicago	\$1,074,505,000	\$7,549,710,000
7	Massachusetts Institute of Technology	\$1,404,588,000	\$13,474,743,000
8	Duke University	\$472,923,000	\$7,296,545,000
9	University of Pennsylvania	\$808,409,000	\$10,133,569,000
10	California Institute of Technology	\$523,729,000	\$2,198,877,000
10	Johns Hopkins University	\$560,478,000	\$3,412,617,000
12	Dartmouth College	\$593,952,000	\$4,663,491,000
12	Northwestern University	\$983,556,000	\$10,193,037,000
14	Brown University	\$425,750,000	\$3,073,349,000
15	Cornell University	\$926,900,000	\$6,037,546,000
15	Vanderbilt University	\$603,708,000	\$4,133,542,000
15	Washington University in St. Louis	\$1,365,854,000	\$6,818,748,000
18	Rice University	\$1,068,633,000	\$5,557,479,000
18	University of Notre Dame	\$605,630,000	\$8,566,952,000
20	Emory University	\$1,153,875,000	\$6,684,305,000
20	Georgetown University	\$242,255,000	\$1,528,869,000
	Average	\$1,243,527,238	\$10,377,609,000

Whatever the increase in endowment size from 1990 to 2015 purchased, it is quite clear that it did not purchase more education.¹¹¹ As shown in Table 5, during this period, the average full-time undergraduate enrollment at the top-twenty private universities increased by an anemic 22.1%, from 5,376 to 6,564 students. This increase works out to an annual compounded rate of only 0.80%.¹¹² During this period, the average amount of endowed funds per full-time undergraduate student at the top-twenty private universities increased from \$231,311 to \$1,580,989.¹¹³

Table 5¹¹⁴

Rank	School	1990 Full-Time Undergraduate Enrollment	2015 Full-Time Undergraduate Enrollment
1	Princeton University	4,497	5,275
2	Harvard University	6,587	6,688
3	Yale University	5,185	5,470
4	Columbia University	3,265	6,170
4	Stanford University	6,505	7,019
4	University of Chicago	3,382	5,616
7	Massachusetts Institute of Technology	4,242	4,476
8	Duke University	5,950	6,601

¹¹¹ See *infra* Table 5 (noting that the percentage increase in endowment size far outpaced the increase in undergraduate enrollment increases).

¹¹² See *id.*

¹¹³ Compare *supra* Table 4, with *infra* Table 5.

¹¹⁴ Undergraduate enrollment data was obtained from U.S. News and World Report. See *Directory of Colleges and Universities*, U.S. NEWS & WORLD REP., 2015 [hereinafter *Directory* 2015]; *Directory of Colleges and Universities*, U.S. NEWS & WORLD REP., 1990 [hereinafter *Directory* 1990].

9	University of Pennsylvania	9,395	9,437
10	California Institute of Technology	796	983
10	Johns Hopkins University	3,170	6,161
12	Dartmouth College	3,795	4,228
12	Northwestern University	7,331	8,278
14	Brown University	5,608	6,255
15	Cornell University	12,716	14,453
15	Vanderbilt University	5,157	6,778
15	Washington University in St. Louis	4,916	6,686
18	Rice University	2,741	3,872
18	University of Notre Dame	7,500	8,340
20	Emory University	4,711	7,732
20	Georgetown University	5,449	7,226
	Average	5,376	6,564

While endowments have had at most a negligible impact on the number of students being educated, it is conceivable that they have had a greater impact either on the cost of education or on educational

quality.¹¹⁵ Unfortunately, it is difficult to measure either of these potential impacts.¹¹⁶ To assess any impact endowments may have on cost, we must compare the actual change in the cost of a university education to the change that would have occurred had the universities not had their endowments. Unfortunately, this comparison presents a counterfactual, so I can only offer a conjecture.¹¹⁷ But I am skeptical that endowment growth has placed any serious restraint on the cost of a university education.¹¹⁸ When the ever-increasing sticker price of these elite educations is compared to the personal consumption expenditures index generally,¹¹⁹ it is hard to believe

¹¹⁵ See Sarah E. Waldeck, *The Coming Showdown Over University Endowments: Enlisting the Donors*, 77 *FORDHAM L. REV.* 1795, 1798 (2009). See also, e.g., Thomas M. Stauffer, *Quality in American Education*, in *QUALITY—HIGHER EDUCATION'S PRINCIPAL CHALLENGE* 1, 2 (Thomas M. Stauffer ed., 1981) (“Quality is someone’s subjective assessment, for there is no way of objectively measuring what is in essence an attribute of value.” (quoting ALLAN M. CARTER, *AN ASSESSMENT OF QUALITY IN GRADUATE EDUCATION* 4 (1966)) (emphasis in original) (internal quotation marks omitted).

¹¹⁶ See, e.g., Stauffer, *supra* note 115, at 2.

¹¹⁷ Many supporters of the current tax treatment of college and university endowments are more than willing to claim that educational endowments directly impact educational quality, however. See, e.g., Anthony W. Marx, *Defending College Endowments*, *L.A. TIMES* (Oct. 12, 2008), <http://www.latimes.com/la-oe-marx12-2008oct12-story.html> (“It’s a good thing that colleges have been allowed to tend to [their] resources as needed Because . . . endowed colleges can now use that money to continue to offer generous financial aid packages for our nation’s best, brightest and neediest students”); *Myths About College and University Endowments*, *ASS’N AM. UNIV.* 2 (Jan. 26, 2009), <https://www.aau.edu/WorkArea/DownloadAsset.aspx?id=7792> (“For colleges and universities with sizable endowments, the difference [between the tuition charged by the institution and the cost of education per individual] is subsidized by earnings from their endowments.”). But even if the subsidization argument were true, the increase in demand for the services these colleges and universities provide caused by this subsidization would theoretically result in an increase—rather than a decrease—in the cost to the individual student. See Waldeck, *supra* note 117, at 1798.

¹¹⁸ See, e.g., Alexander E.M. Hess & Samuel Weigley, *Universities Getting the Most Government Money*, 24/7 *WALL ST.* (Apr. 25, 2013, 6:43 AM), <http://247wallst.com/special-report/2013/04/25/universities-getting-the-most-government-money/> (discussing how schools with substantial endowments also receive the greatest amount of federal funding).

¹¹⁹ See, e.g., Janet Lorin, *College Tuition in the U.S. Again Rises Faster Than Inflation*, *BLOOMBERG* (Nov. 13, 2014, 12:01 AM), <http://www.bloomberg.com/>

that endowment growth can possibly have had any positive effect on keeping education prices in check.¹²⁰ As shown in Table 6, full-time tuition at these elite universities during the relevant period increased 237.84% from an average of \$14,061 to an average of \$47,504, which works out to a 4.99% annualized rate. During the same period, consumer prices increased 81%, which works out to a 2.40% annualized rate.¹²¹ In other words, notwithstanding a massive increase in the size of endowments, tuition rose, year-in and year-out, at more than twice the rate of inflation.¹²²

Table 6¹²³

Rank	School	1990 Full-Time Tuition & Fees	2015 Full-Time Tuition & Fees
1	Princeton University	\$15,440	\$43,450
2	Harvard University	\$14,450	\$45,278
3	Yale University	\$15,180	\$47,600
4	Columbia University	\$14,472	\$51,008
4	Stanford University	\$14,280	\$46,320

news/articles/2014-11-13/college-tuition-in-the-u-s-again-rises-faster-than-inflation (noting that at private and public institutions, tuition and fee expenses have generally outpaced any increases to the consumption expenditures index).

¹²⁰ Indeed, one can argue that the schools capture the benefits generated by endowments. *See, e.g.,* Waldeck, *supra* note 115, at 1817–18.

¹²¹ The percentage rate increase of consumer prices was derived by using the Bureau of Labor Statistics' CPI calculator to compute the amount required to buy the same basket of goods in 2015 that could have been purchased for \$1.00 in 1990. *See CPI Inflation Calculator*, BUREAU OF LAB. STAT., U.S. DEP'T OF LAB., http://www.bls.gov/data/inflation_calculator.htm (last visited Apr. 5, 2015).

¹²² *See also* Danielle Kurtzleben, *Charts: Just How Fast Has College Tuition Grown?*, U.S. NEWS & WORLD REP. (Oct. 23, 2013, 3:56 PM), <http://www.usnews.com/news/articles/2013/10/23/charts-just-how-fast-has-college-tuition-grown>.

¹²³ Tuition data were obtained from U.S. News and World Report. *See Directory*, 2015, *supra* note 114; *Directory* 1990, *supra* note 114.

4	University of Chicago	\$14,895	\$50,193
7	Massachusetts Institute of Technology	\$15,600	\$46,704
8	Duke University	\$13,760	\$49,341
9	University of Pennsylvania	\$13,450	\$49,536
10	California Institute of Technology	\$13,300	\$45,390
10	Johns Hopkins University	\$15,000	\$48,710
12	Dartmouth College	\$15,267	\$49,506
12	Northwestern University	\$13,725	\$49,047
14	Brown University	\$15,295	\$49,346
15	Cornell University	\$15,164	\$49,116
15	Vanderbilt University	\$13,975	\$43,838
15	Washington University in St. Louis	\$14,800	\$48,093
18	Rice University	\$6,900	\$42,253
18	University of Notre Dame	\$12,390	\$47,929
20	Emory University	\$13,500	\$46,314
20	Georgetown University	\$14,440	\$48,611
	Average	\$14,061	\$47,504

Unfortunately, unlike quantity or cost, it is next to impossible to measure the quality of the educations being delivered.¹²⁴ One could analyze a time series of standardized test scores for graduate and professional schools, such as the GRE, the LSAT, the MCAT, or the GMAT, to see how performance has changed over the last twenty-five years.¹²⁵ However, some college students (even at elite universities) do not take these tests.¹²⁶ Moreover, the makeup of these tests and the grading of these tests has changed over time.¹²⁷

¹²⁴ See, e.g., Stauffer, *supra* note 115, at 2 (“Quality is someone’s subjective assessment, for there is no way of objectively measuring what is in essence an attribute of value.” (quoting ALLAN M. CARTTER, AN ASSESSMENT OF QUALITY IN GRADUATE EDUCATION 4 (1966)) (emphasis in original) (internal quotation marks omitted).

¹²⁵ U.S. News and World Report bases their school rankings in part on these test scores. See, e.g., Robert Morse, Eric Brooks, & Matt Mason, *How U.S. News Calculated the 2017 Best Colleges Rankings*, U.S. NEWS & WORLD REP. (Sept. 12, 2016, 10:00 PM), <http://www.usnews.com/education/best-colleges/articles/how-us-news-calculated-the-rankings>; Brian Huddleston, *USN&WR Law School Rankings, Color-Coded Changes, 2015 to 2016 Editions*, BRIAN HUDDLESTON BLOG (Mar. 25, 2015, 12:56 PM), <http://brianhuddleston.blogspot.com/2015/03/usn-law-school-rankings-color-coded.html>; Ry Rivard, *Lowering the Bar*, INSIDE HIGHER EDUC. (Jan. 16, 2015), <https://www.insidehighered.com/news/2015/01/16/law-schools-compete-students-many-may-not-have-admitted-past> (noting that the median LSAT scores of admitted law students have been in a state of decline). *But see* Jack Schneider & Anil Nathan, *How to Measure School Quality*, EDUC. WEEK (Oct. 29, 2013), <http://www.edweek.org/ew/articles/2013/10/30/10schneider.h33.html>.

¹²⁶ See Delece Smith-Barrow, *As Law Schools Undergo Reform, Some Relax LSAT Requirements*, U.S. NEWS & WORLD REP. (Apr. 2, 2015, 9:00 AM), <http://www.usnews.com/education/best-graduate-schools/top-law-schools/articles/2015/04/02/as-law-schools-undergo-reform-some-relax-lsat-requirements>; Todd Johnson, *BS/MD Programs That Don’t Require the MCAT*, COLL. ADMISSIONS PARTNERS (Feb. 18, 2014), <http://www.collegeadmissionspartners.com/bsmd-programs/bsmd-programs-dont-require-mcat/>; Aidan Sullivan, *Ten Graduate School Programs That Don’t Require the GRE*, ACCEPT U (Oct. 5, 2015) <http://acceptu.com/2015/10/ten-graduate-school-programs-dont-require-gre/>; Rachel Beckstead, *MBA No GMAT: MBA Programs That Don’t Require the GMAT*, COLL. ATLAS (June 7, 2016), <https://www.collegeatlas.org/mba-programs-that-dont-require-gmat>.

¹²⁷ See, e.g., Jamie Gumbrecht, *Major Changes Coming to 2016 SAT Test: Here’s What, How and Why*, CNN, <http://www.cnn.com/2014/03/05/living/sat-test-changes-schools/> (last updated Mar. 6, 2014, 10:34 AM); Morse, Brooks, & Mason, *supra* note 125 (factoring SAT and ACT scores into a school’s “selectivity score” only for those students who actually took the tests).

Thus, comparing test results from different years would be largely meaningless. And in any event, such comparisons would arguably be measuring the wrong thing.¹²⁸ To wit, at least one commentator has persuasively argued that value-added is the only valid measure of the quality of any education because value-added is the only objective market assessment of educational quality.¹²⁹

While difficult, it is generally possible to determine the value-added of a particular education.¹³⁰ I opt here, however, for something simpler. I will compare the value-added from a private university education to the value-added from the closest competing product, a public university education. My data is the entry-level and mid-career salaries earned by graduates of the top-twenty private universities and the top-ten public universities. See Table 7. My aim is to produce a crude measure of excess-bang-for-the-excess-buck. That is, I will determine what kind of return private university students receive in the employment market in exchange for the additional tuition that they pay to private universities.¹³¹

¹²⁸ See *id.*; *supra* note 126.

¹²⁹ See generally Douglas C. Bennett, *Assessing Quality in Higher Education*, 87 LIBERAL EDUC. 40, 40–45 (2001). For other perspectives on how to measure educational quality, see generally RICHARD ARUM & JOSIPA ROKSA, *ACADEMICALLY ADRIFT: LIMITED LEARNING ON COLLEGE CAMPUSES* 59–89 (2011) (evaluating institutions by selectivity and college major relative to the required reading and writing requirements for classes at those institutions, as well as using other criteria); Lewis C. Solomon, *A Multidimensional Approach to Quality*, in *QUALITY—HIGHER EDUCATION’S PRINCIPAL CHALLENGE* 6–14 (Thomas M. Stauffer ed., 1981) (suggesting criteria subjective to an institution’s and its students’ specific goals while also noting “value added” as a key consideration in developing these criteria).

¹³⁰ See, e.g., Herwig Schlunk, *Mamas Don’t Let Your Babies Grow Up To Be . . . Lawyers* 1–4 (Vanderbilt Univ. Law Sch., Working Paper No. 09-29, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1497044 (specifically the methodology employed to value law degrees).

¹³¹ See, e.g., Jonathan D. Glater, *Weighing the Costs in Public vs. Private College*, N.Y. TIMES (Dec. 13, 2006), <http://www.nytimes.com/2006/12/13/education/13voices.html> (noting that for many the cost of attendance should be a consideration when selecting a university). See also Valerie Strauss, *Costs of Public vs. Private College*, WASH. POST: THE ANSWER SHEET (Jan. 12, 2010, 6:30 AM), <http://voices.washingtonpost.com/answer-sheet/college-costs/comparing-costs-of-public-priv.html> (showing the disparity between public and private educational institution prices).

What does the data show? The excess of the tuition at a top-twenty private university over the in-state tuition at a top-ten public university averages \$33,982 per year, for an aggregate of \$135,928 over the course of a four-year college education.¹³² In exchange for this additional tuition, graduates of the private universities earn, on average, an additional \$6,646 in their first year of employment and an additional \$11,950 per year in the middle of their careers.¹³³ While determining the appropriate discount rate to apply for the purpose of valuing these incremental earnings would be difficult and controversial, even relatively modest discount rates support the argument that private university students earn, at best, a fair return on their excess tuition expenditures.¹³⁴

¹³² See *infra* Table 7.

¹³³ See *id.*

¹³⁴ For example, assume that incremental wages begin at \$6,646, grow to \$11,950 after fifteen years in the workforce, and (improbably) continue to grow at that same rate for the remainder of a forty-year career. In that case, if a discount rate of 8% is applied, the incremental wages have a net present value of \$134,200, or slightly less than the incremental tuition that was paid to achieve them. For reasons I have articulated elsewhere, one could argue that 8% is an indefensibly low discount rate to apply to such incremental wages. See Schlunk, *supra* note 133, at 7–8.

Table 7
Part A¹³⁵

Rank	Private School	2015 Full-Time Tuition	2015 Starting Median Salary	Mid-Career Median Salary
1	Princeton University	\$43,450	\$61,300	\$122,000
2	Harvard University	\$45,278	\$61,400	\$126,000
3	Yale University	\$47,600	\$60,300	\$104,000
4	Columbia University	\$51,008	\$60,200	\$104,000
4	Stanford University	\$46,320	\$65,900	\$123,000
4	University of Chicago	\$50,193	\$50,600	\$107,000
7	Massachusetts Institute of Technology	\$46,704	\$74,900	\$124,000
8	Duke University	\$49,341	\$60,600	\$111,000
9	University of Pennsylvania	\$49,536	\$60,300	\$120,000
10	California Institute of Technology	\$45,390	\$72,600	\$125,000
10	Johns Hopkins University	\$48,710	\$57,500	\$97,500
12	Dartmouth College	\$49,506	\$56,300	\$111,000

¹³⁵ For tuition data, see *National University Rankings*, supra note 106 (data accessed through each school's individual profile). For salary data, see *2015-2016 PayScale College Salary Report*, PAYSACLE, <https://web.archive.org/web/20160313085131/http://www.payscale.com/college-salary-report/bachelors> (data retrieved from March 13, 2016 archived site because website figures were updated to reflect the 2016-2017 academic year).

12	Northwestern University	\$49,047	\$56,300	\$102,000
14	Brown University	\$49,346	\$57,100	\$108,000
15	Cornell University	\$49,116	\$59,700	\$109,000
15	Vanderbilt University	\$43,838	\$57,300	\$102,000
15	Washington University in St. Louis	\$48,093	\$55,500	\$105,000
18	Rice University	\$42,253	\$63,900	\$114,000
18	University of Notre Dame	\$47,929	\$57,400	\$106,000
20	Emory University	\$46,314	\$51,300	\$89,800
20	Georgetown University	\$48,611	\$51,800	\$110,000
	Average	\$47,504	\$59,629	\$110,490

Table 7
Part B

Rank	Public School	2015-16 In-State Tuition & Fees	2015-16 Starting Median Salary	Mid- Career Median Salary
1	University of California, Berkeley	\$13,432	\$59,500	\$114,000
2	University of California, Los Angeles	\$12,753	\$51,800	\$96,900
3	University of Virginia	\$14,526	\$54,700	\$97,600

4	University of Michigan at Ann Arbor	\$14,336	\$58,000	\$96,000
5	University of North Carolina at Chapel Hill	\$8,562	\$46,200	\$79,400
6	College of William and Mary	\$16,919	\$45,900	\$92,500
7	Georgia Institute of Technology	\$12,204	\$62,500	\$112,000
8	University of California at Santa Barbara	\$13,865	\$49,400	\$96,300
9	University of California at Irvine	\$14,577	\$49,900	\$97,700
9	University of California at San Diego	\$14,042	\$52,400	\$103,000
	Average	\$13,522	\$53,030	\$98,540

This result is hardly surprising. Giving private university educations the benefit of the doubt by treating the return earned on excess tuition payments as a full, fair market return, the result says nothing more than that, from the perspective of buyers (that is, the students or their parents), the market for a college education appears to be efficient. Private university students get what their tuition dollars pay for, no less and no more. But this observation in turn casts a troubling shadow over the grant of tax preferences to private university endowments.

I take it as an article of faith that the only legitimate beneficiaries of private university endowments are university students.¹³⁶ That is,

¹³⁶ See *supra* Introduction, at 3. Cf. Paul G. Haskell, *The University as Trustee*, 17 GA. L. REV. 1, 5 (1982) (“[T]he university is indeed a model of fiduciary responsibility to students and the community at large. As a fiduciary it should be accountable to those it serves . . .”).

the federal government has a public goal of having an educated populace.¹³⁷ When the government provides education directly, that is through the states, it takes value in the form of taxes from those who are, on balance, already better educated (i.e., workers and investors) and transfers such value in the form of a public university education to those who are on balance less educated (i.e., students).¹³⁸ Alternatively, when the government provides education indirectly by granting tax benefits to private donors, it allows some of those who are, on balance, already better educated (i.e., donors) to take value in the form of net contributions to private universities and the accompanying federal tax expenditures and effectively transfer such value in the form of a private university education to those who are, on balance, less educated (i.e., students).¹³⁹ In other words, the purpose of diverting what would otherwise be public funds to private university endowments is to educate—and consequently transfer value to—private university students.¹⁴⁰

If such a transfer is indeed occurring, then I should find, given the massive increase in the amount of would-be public funds that have been diverted to private university endowments during the past two-and-a-half decades,¹⁴¹ that private university students earn a significant extraordinary return on their excess tuition dollars.¹⁴² This extraordinary return would represent the amount of value transferred by the endowments to the students. In addition, I should find that such extraordinary return was increasing over time, reflecting the increase in the size of the endowments.¹⁴³ In light of these expected findings, the result of a merely fair return on excess tuition dollars is disappointing.

If private university endowments are not financing extraordinary returns for private university students, relative to the returns those

¹³⁷ *But see* Colombo, *supra* note 73, at 844–45 (arguing that while the legislative history behind the tax exemption of educational institutions is nonexistent, the exemption has its origins in the former ministerial purposes of those institutions).

¹³⁸ *See supra* Part II.

¹³⁹ *See id.*

¹⁴⁰ *Cf.* Hansmann, *Why Are Colleges and Universities Exempt from Taxes?*, *supra* note 18 (minus 117), at 4.

¹⁴¹ *See supra* Table 4.

¹⁴² *See supra* Table 7.

¹⁴³ *Compare supra* Table 4, *with supra* Table 7.

students would achieve by instead investing in public university educations, they must be financing something else. There are two possibilities. The first possibility is that private university endowments may be financing transfers of value to students that precisely offset any transfers of value such students would receive if such students instead attended public universities. This would be quite a coincidence. Among its requirements is that public university students must in fact be receiving transfers of value. They may be: a public university education may be more valuable than the tuition spent to purchase it. Suppose that it is. If excess tuition spent on a private university education produces exactly a fair return, it follows that a private university education is also more valuable than the tuition spent to purchase it, indeed *by exactly the same amount* as a public university education. If there is such a transfer of value in the case of a private university education, it must be funded somehow—private university endowments are the most likely source of such funding.¹⁴⁴

There is a second possibility. Private university endowments may be financing expenditures that provide little or no benefit to students at all. For example, private universities may be using their endowments to finance ever-larger faculties with ever-lighter teaching loads.¹⁴⁵ Or, they may be inefficiently throwing additional dollars at items such as enhanced physical plant, higher faculty salaries, and increased overhead, including larger administrative staffs and higher administrative salaries.¹⁴⁶

¹⁴⁴ Cf. JORGE KLOR DE ALVA & MARK SCHNEIDER, NEXUS RES. & POL'Y CTR., *Rich Schools, Poor Students: Tapping Large University Endowments to Improve Student Outcomes* 4–9 & tbl. 1 (Apr. 2015), available at http://nexusresearch.org/wp-content/uploads/2015/04/Rich_Schools_Poor_Students.pdf (the amount of tax subsidies for private universities with high endowments is substantially greater than that for public universities).

¹⁴⁵ See, e.g., Andrew J. Rotherham, *College Endowments: Why Even Harvard Isn't as Rich as You Think*, TIME (Feb. 9, 2012), <http://ideas.time.com/2012/02/09/college-endowments-why-even-harvard-isnt-as-rich-as-you-think/> (“When your alma mater calls you and asks for a donation, it’s really hoping you’ll give to its general fund, where the use of your donation is unrestricted. Donations [given] for scholarships or specific degrees, programs or activities can be used only for those purposes.”).

¹⁴⁶ See, e.g., Douglas Belkin & Scott Thurm, *Deans List: Hiring Spree Fattens College Bureaucracy—And Tuition*, WALL ST. J. (Dec. 28, 2012, 10:30 PM), <http://www.wsj.com/articles/SB100014241278873233168045781614907160428>

The available data on faculty size are, unfortunately, nearly impossible to parse. U.S. News and World Report changed its reporting during the period beginning in 1990, initially reporting “faculty size” as a number but subsequently switching to crude student-faculty ratios. Moreover, is it unclear what persons are included in either measure of faculty. Are a medical school’s clinical faculty included? What about adjunct professors, graduate students, teaching assistants, and so forth? Sadly, the dearth of clarity means that any statement on my part about the impact of endowment size on faculty size would be nothing more than speculation. Maybe there has been such an impact. Maybe not. And I similarly cannot say anything definitive about the impact of endowment size on physical plant, faculty salaries, or administrative staff size (although I confess to having strong suspicions that each of these has indeed been positively impacted).

But I can say something definitive about administrative remuneration: it has almost certainly been a beneficiary of increased endowment size, at least if chief executive compensation is any guide.¹⁴⁷ Such compensation at the top-twenty private universities increased 680.83% from 1990 to 2013, from an average of \$213,704 to an average of \$1,668,667.¹⁴⁸ This works out to an annualized rate of 9.35%, or nearly four times the rate of inflation, year-in and year-out.¹⁴⁹

14; Paul F. Campos, *The Real Reason College Costs So Much*, N.Y. TIMES, (Apr. 4, 2015), <http://www.nytimes.com/2015/04/05/opinion/sunday/the-real-reason-college-tuition-costs-so-much.html>. *But see* Danielle Douglas-Gabriel, *College Tuition is Getting More Expensive. Here’s Who’s Actually to Blame.*, WASH. POST (Apr. 7, 2015), <http://www.washingtonpost.com/blogs/wonkblog/wp/2015/04/07/college-tuition-is-getting-more-expensive-heres-whos-actually-to-blame/> (arguing that the rise in the “professional staff” may be outweighing the size—and cost—of the administrative staff).

¹⁴⁷ *See infra* Table 8.

¹⁴⁸ *See infra* Table 8. This applies to those twenty schools other than Georgetown, for which data was either available in both years or was available for at least relatively contemporaneous years. *See id.*

¹⁴⁹ *Compare infra* Table 8, with *CPI Inflation Calculator*, *supra* note 124 (annualized inflation rate is 2.4%).

Table 8¹⁵⁰

Rank	School	1990 CEO Compensation	2013 CEO Compensation
1	Princeton University	\$188,917	\$730,631 + \$931,327 = \$1,661,958
2	Harvard University	\$148,383	\$929,584
3	Yale University	\$187,500	\$771,987 + \$1,119,974 = \$1,891,961
4	Columbia University	\$297,000	\$4,615,230
4	Stanford University	\$194,375	\$963,248
4	University of Chicago	\$222,500	\$1,337,869
7	Massachusetts Institute of Technology	\$226,000	\$878,324
8	Duke University	\$214,456	\$1,159,855
9	University of Pennsylvania	\$250,000	\$3,065,746
10	California Institute of Technology	\$200,000	\$640,295 + 454,887 = \$1,095,182

¹⁵⁰ Data on chief executive compensation was obtained from: Brian O’Leary & Joshua Hatch, *Executive Compensation at Private and Public Colleges*, CHRON. HIGHER EDUC. (Dec. 4, 2016), http://chronicle.com/interactives/executive-compensation#id=table_private_2013 (phrase searched is as follows: “In 2013, which private-college leaders earned the highest total compensation in the U.S.?”). I limited the comparison of chief executive compensation to the 15 chief executives at those private universities for which I was able to find compensation information for both years. *See id.* The figures included in Table 8 denote each executive’s total compensation for 2013 as calculated by The Chronicle of Higher Education, including base pay, bonus pay, nontaxable compensation, other compensation, and deferred compensation set aside.

10	Johns Hopkins University	\$225,649	\$1,629,325+ \$3,821,566 = \$5,450,891
12	Dartmouth College	\$309,764 (1992-1993)	\$669,618 + \$580,552 = \$1,250,170
12	Northwestern University	\$198,500	\$1,211,285
14	Brown University	\$223,588 (1991-1992)	\$739,681
15	Cornell University	\$112,690	\$907,191
15	Vanderbilt University	\$300,000	\$2,147,452
15	Washington University in St. Louis	\$105,000	\$1,004,194
18	Rice University	\$210,959 (1990-1991)	\$1,067,362
18	University of Notre Dame	\$196,396 (1991-1992)	\$956,393
20	Emory University	\$262,384 (1991-1992)	\$1,039,772
20	Georgetown University	\$345,529 (1998)	\$851,304
	Average	\$213,704	\$1,668,667

My objective in this analysis is not to criticize private university chief executive compensation. Nonetheless, I want to make two points about such compensation. First, the mere fact that such compensation may be lower than the compensation of many chief executives in the private sector does not mean that it is not excessive.¹⁵¹

¹⁵¹ See Jaeah Lee & Maggie Severns, *Charts: When College Presidents Are Paid Like CEOs*, MOTHER JONES (Sept. 5, 2013, 5:00 AM), <http://www.motherjones.com/politics/2013/09/charts-college-presidents-overpaid-pay> (comparing college and university faculty and executive pay). See generally Brian Galle & David I. Walker, *Nonprofit Executive Pay as an Agency Problem: Evidence from U.S. Colleges and Universities*, 94 B.U.L. REV. 1881, 1895–1904 (2014) (arguing

Private sector compensation only provides a relevant comparison for private university chief executives with the ability and the desire to relocate to the private sector.¹⁵² Given that such relocations are extremely rare, it seems implausible that very many private university chief executives have that ability or desire. Second, and far more importantly, the fact that private university chief executive compensation is determined by competition between various universities does not mean that it is not, in an important sense, excessive.¹⁵³ A numerical example will illustrate why.

Suppose that Bob is a potential university chief executive who would command a salary of \$500,000 in the private sector and who places a value of \$200,000 plus a penny on being in academia. So long as a university offers Bob \$300,000 of compensation, Bob will become or remain an academic. This is true regardless of Bob's actual value to academia. Nonetheless, for purposes of this illustration, assume that Bob's value as a university administrator, *excluding* his value as a raiser of endowed funds, is exactly \$300,000. In that case, in a world without endowments, any university should be willing to pay Bob \$300,000 of compensation, and Bob should happily accept such amount.

Now suppose that Bob has the additional skill of being a relatively efficient raiser of endowed funds. Indeed, suppose he is capa-

that constraints on nonprofit manager pay may be even weaker than such constraints in the for-profit sector).

¹⁵² See Lee & Severns, *supra* note 151 ("Where the networks of corporate directors and trustees are dense and overlapping, as CEO compensation in the corporate sector increases, a similar logic may well be applied to CEO compensation in private universities."). But see Galle & Walker, *supra* note 151, at 1894 ("Of course, nonprofit executives must be paid a competitive wage. The difficulty lies in distinguishing between competitive compensation, which is allowed, and 'excess benefit transactions' that represent forbidden private inurement.").

¹⁵³ Sam Sanders, *America's Highest-Paid Private-University President Made \$7.1 Million In 2012*, NAT'L PUB. RADIO (Dec. 8, 2014, 5:43 PM), <http://www.npr.org/blogs/thetwo-way/2014/12/08/369400033/americas-highest-paid-private-university-president-made-7-1-million-in-2012> ("[L]egitimate questions can be raised about at what point does compensation press the bounds of appropriateness, given the types of institutions [college presidents] lead, and the exemptions they're afforded under the federal tax code[.]") (internal quotation marks omitted).

ble of raising incremental endowed funds that in turn allow the university to increase its annual spending by \$50,000.¹⁵⁴ Bob's university would like to reap the benefit of this windfall. But so would every other university. Thus, when the dust settles, some university will likely offer Bob compensation of just under \$350,000; Bob's raise reflects his incremental fund-raising prowess. But, note that this means that Bob, rather than his university, reaps the entire value of the incremental funds flowing into the endowment.¹⁵⁵

This argument extends far beyond the office of chief executive. For example, the presence of certain faculty members at a university may lead to enhanced endowment fundraising.¹⁵⁶ The presence of larger administrative staffs may lead to enhanced endowment fundraising.¹⁵⁷ The presence of a nicer football stadium may lead to enhanced endowment fundraising.¹⁵⁸ In the first case, the relevant faculty members will, in the limit, enjoy increases in their compensation that completely swallow up their "contribution" to the endowment.¹⁵⁹ In the second case, the administrative staff will, in the limit, see an increase in its budget that completely swallows up its "contribution" to the endowment.¹⁶⁰ And in the third case, the nicer football stadium will be built so long as the cost is at least one penny less than the amount it "adds" to the endowment.¹⁶¹

¹⁵⁴ For example, based solely on his charisma, Bob might be able to raise \$1 million more of endowed funds than would the typical university president. In that case, if Bob's university endowment has a 5% payout rate, Bob would provide the university with approximately an additional \$50,000 per year to spend.

¹⁵⁵ Given that money is fungible, this will be true no matter how the endowed funds are restricted.

¹⁵⁶ See, e.g., *New Professorship Honors Longtime Pharmaceutical Researcher*, KU NEWS (Apr. 13, 2015), <http://news.ku.edu/2015/04/13/new-professorship-honors-longtime-pharmaceutical-researcher>.

¹⁵⁷ See, e.g., Emily Lane, *LSU Tables Plan to Create Vice President to Oversee Fundraising Orgs*, THE TIMES-PICAYUNE (Mar. 19, 2015, 6:50 PM), http://www.nola.com/news/baton-rouge/index.ssf/2015/03/lsu_foundation_moret_search.html.

¹⁵⁸ See, e.g., Riley Blevins, *Ole Miss AD Ross Bjork Agrees to 4-Year Extension*, THE CLARION-LEDGER (Apr. 17, 2015, 11:19 AM), <http://www.clarion-ledger.com/story/olemisssports/2015/04/17/ole-miss-ad-ross-bjork-agrees-to-4-year-extension/25934979/>.

¹⁵⁹ See, e.g., KU NEWS, *supra* note 156.

¹⁶⁰ See, e.g., Lane, *supra* note 157.

¹⁶¹ See, e.g., *id.*

I am enough of a capitalist that I generally have no particular objection to the earning of economic rents.¹⁶² But these are artificially created rents: from a societal perspective, they are nothing more than excessive payments.¹⁶³ In each and every case, the payment is financed by a diversion of what should have been federal tax revenue.¹⁶⁴ That is, scarce money that would otherwise have been available to the federal government to pursue public goals will instead find its way into a private university endowment, where it will effectively be earmarked to pay a perpetual rent to someone (or something) at the university.¹⁶⁵ Importantly, none of the diverted tax revenue will provide any educational benefit to the university's students.¹⁶⁶ Thus, as shown in Table 2.6 (which modifies prior Table 2.4), it is possible that a tax deductible contribution to a private university endowment will lead not only to a lower level of aggregate spending on public goals, but to *no* actual spending on higher education!

Table 2.6 (Potential Cash Contribution)	Grant of Federal Revenue to State to Fund Education	Deduction for Contributions used to Fund Education
Current Non-Education Spending Controlled by Federal Government	\$27 million	\$27 million
Current Education Spending Controlled by Federal Government	\$3 million	\$0

¹⁶² See generally Robert H. Wessel, *A Note on Economic Rent*, 57 AM. ECON. REV. 1221, 1222 (1967) (defining "economic rent" and the "Paretian rent" concept).

¹⁶³ See generally Anne O. Krueger, *The Political Economy of the Rent-Seeking Society*, 64 AM. ECON. REV. 291, 291–303 (1974); Kevin M. Murphy, Andrei Shleifer, & Robert W. Vishny, *Why Is Rent-Seeking So Costly to Growth?*, 83 AM. ECON. REV. 409, 409–14 (1993).

¹⁶⁴ See *supra* Part III.

¹⁶⁵ See *id.*

¹⁶⁶ See *supra* Part III–IV.

NPV of Future Education and Non-Education Spending Controlled by Federal Government	\$7 million	\$0
NPV of Future Rents Paid to Providers of Private University Educations	\$0	\$7.143 million

So, which is it? Do private university endowments finance transfers to students that precisely offset any transfers such students would receive if such students instead attended public universities? Or do they merely finance rents unrelated to the quality of education? I tend to think they do some of both, but that the mix has changed dramatically over time. Thus, if one goes back far enough in time, to the halcyon days when university administrators devoted themselves to the educational mission rather than to fundraising, endowment dollars almost surely primarily funded the educational mission.¹⁶⁷ But then private university administration evolved to where it became largely synonymous with fundraising.¹⁶⁸ In that world, which is the current world, newly-raised endowed funds will almost surely fund anything and everything except the educational mission.¹⁶⁹

¹⁶⁷ See, e.g., Benjamin Ginsburg, *Administrators Ate My Tuition*, WASH. MONTHLY (Sept./Oct. 2011), http://www.washingtonmonthly.com/magazine/septemberoctober_2011/features/administrators_ate_my_tuition031641.php?page=all (describing the change in university administrators' view of their role, shifting from a view "that the purpose of a university [is] the promotion of education and research" to a "view [that] management [is] an end in and of itself.").

¹⁶⁸ See, e.g., *id.*; Jon Marcus, *New Analysis Shows Problematic Boom in Higher Ed Administrators*, THE NEW ENG. CTR. FOR INVESTIGATIVE REPORTING (Feb. 6, 2014), <http://necir.org/2014/02/06/new-analysis-shows-problematic-boom-in-higher-ed-administrators/>.

¹⁶⁹ A number of scholars have recently written on the subject of the possibility of reforming the taxation of private university endowments. See generally, e.g., Waldeck, *supra* note 115. Waldeck focuses on what she terms "excessively large" endowments, measured on the basis of endowment per full-time student, and seeks primarily to spur such excessively large endowments to stem the rise in tuition. See *id.* at 1799, 1801–03. While she makes no serious proposals as to the treatment of endowments that are currently excessive, she does offer very creative proposals that would help prevent endowments from becoming more excessive in the future. See generally *id.* at 1812–22. To wit, she would limit the tax deduction

V. CONCLUSION

I have demonstrated that financing higher education in part by means of tax deductible donations to educational endowments is unsound from a theoretical standpoint: the tax preference not only allows private donors to control the disposition of funds that the federal government would otherwise control, but also actually reduces the aggregate amount of funds available to satisfy all public goals.¹⁷⁰ No appreciable public benefits are obtained in exchange for the loss of control—much flexibility is sacrificed.¹⁷¹ And obviously, no public benefit can accrue from reducing the funds available to satisfy public goals. Finally, when the would-be public funds are diverted to private endowments, those funds will, to a great extent, cease to be used to satisfy any public goal at all.¹⁷² Rather, they will be further diverted to the pockets of individuals who are adept at attracting such funds.¹⁷³

I have also demonstrated that real world evidence¹⁷⁴ seems to support the theory. The evidence suggests that increased size of private university endowments has not led to more higher education, to cheaper higher education, or to better higher education.¹⁷⁵ On the other hand, the evidence does suggest that the increased size of private university endowments has led to higher levels of remuneration for private university chief executive officers.¹⁷⁶

In the best of all possible worlds, the federal government could and probably should respond to these observations with some dramatic action such as the confiscation of all private university endow-

in the case of gifts that are targeted at the purchase or construction of depreciable assets (such assets do not necessarily improve the quantity or quality of education, but almost always add to its cost). *See id.* at 1818–19. In addition, she would deny a deduction for any gift that does not specify that it must be spent within twenty-five years. *See id.* at 1819. For the other side of the coin, Cowan argues in favor of the status quo for no better reason than that it is, well, the status quo. *Cf.* Cowan, *supra* note 31, at 551–52.

¹⁷⁰ *See supra* Part III.

¹⁷¹ *See id.*

¹⁷² *See supra* Part IV.

¹⁷³ *See id.*

¹⁷⁴ *See id.*

¹⁷⁵ *See id.*

¹⁷⁶ *See id.*

ments: after all, such endowments contain nothing more than diverted federal tax revenue.¹⁷⁷ But, our Constitution would likely prohibit such action.¹⁷⁸ And in any event, my focus here has been not so much on the existence of endowments, but rather on their ability to grow by means of attracting new gifts that are tax deductible to the donors.

Thus, my policy prescription is that the federal government should, at a minimum, repeal the I.R.C. § 170 deduction for any gift that prohibits the donee institution from immediately spending such gift.¹⁷⁹ Given the vagaries of budgeting, an institution cannot, realistically speaking, immediately spend every gift, at least not in a manner that would benefit students and the public at large. But nothing should prevent the institution from doing so, provided that within such institution's judgment, its mission would best be served by such immediate deployment.¹⁸⁰ In any event, this change to the I.R.C. § 170 deduction would encourage donors to replace problematic larger one-time gifts with smaller much less problematic annual gifts. And that would represent a win for higher education.

¹⁷⁷ See *supra* Part III.

¹⁷⁸ See U.S. CONST. amend. V, cl. 5 (“[N]or shall private property be taken for public use, without just compensation.”); JOHN BOURDEAU ET AL., 26 AM. JUR. 2D EMINENT DOMAIN § 6 (Westlaw 2017).

¹⁷⁹ Federal income tax law does feature some, albeit very limited, restrictions on deductions for donor-restricted gifts. See generally Alan F. Rothschild, Jr., *How Donors May—And May Not—Exercise Control of Charitable Gifts*, 16 TAX’N OF EXEMPTS 110, 110–15 (2004).

¹⁸⁰ As an aside, state law does currently permit the release or modification of donor restrictions on endowment funds under certain limited circumstances. See generally Susan N. Gary, *Charities, Endowments, and Donor Intent: The Uniform Prudent Management of Institutional Funds Act*, 41 GA. L. REV. 1277, 1279–1332 (2007).