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Congress Has Increased the Tax on College and University Endowments: How Should We Think about This Policy Change?

The reconciliation bill passed by the House of Representatives in May 2025 includes a significant increase to the current tax on the incomes from the endowments of private nonprofit colleges and universities. This brief examines the logic behind the long-standing exemption from taxation for educational institutions and other nonprofit charitable organizations, as well as the role of endowments, as context for evaluating this policy change and related proposals.

Why This Matters

The income tax system has always included a tax exemption for charitable institutions, the definition of which clearly includes colleges and universities. A significant tax on income from endowments and other financial assets limits the ability of affected colleges and universities to carry out their missions, which include educating undergraduate and graduate students, performing research, and engaging in other activities benefiting their communities. It is unlikely that the revenues from such a tax will be directed toward any related goals. And it is easy to view excluding selected colleges and universities from receiving the long-standing exemption from taxation for charitable institutions as an arbitrary strategy inconsistent with sound public policy.

What We Found

Nonprofit colleges and universities clearly meet the criteria for tax exemption.

- Concerns about the disproportionate share of students from affluent families at elite colleges and universities are valid but not disqualifying for exemption from taxation.
- The restrictions on political activity by tax-exempt organizations do not extend to the viewpoints or ideologies of the organizations or their members.
- Colleges and universities are fundamentally different from private foundations, so it is logical for their tax treatment to be different.
- The tax exemption is generally viewed as a “tax expenditure,” which has the same effect on the federal budget as a direct subsidy, but it might also be thought of as a separation between the government and charitable organizations, as is the case for churches.
- Unlike the 21 percent tax on corporate profits, the endowment tax does not subtract costs of production from income before calculating taxes due.

Endowments allow colleges and universities to support their missions far into the future, not just to fund current activities. They supplement other revenue sources and protect against an uncertain future.

- There is no clear optimal size for an endowment.
- Endowment per student is a better metric than total endowment size for comparing wealth across institutions, but it is far from a perfect indicator.

- The new tax on investment income will affect fewer institutions than the 1.4 percent tax imposed in 2017 because of the exclusion of small colleges. Neither policy generates significant federal revenue.
- The goal of taxing endowments might be to change institutional behaviors or, like the new tax and the one it replaces, simply to transfer funds from colleges and universities to the federal government.

If the motivation for taxing the endowment income of wealthy colleges and universities is to provide incentives for these institutions to enroll more low-income students, other policy approaches directly related to this goal are likely to be more effective. The government could provide support for college preparation among disadvantaged youth and increase grant aid for low- and moderate-income students. If the concern is the inequality in resources across postsecondary institutions, direct subsidies to the underresourced institutions and their students are more likely to improve educational opportunities.

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