

What the new tax bill means for endowments and foundations



A quick primer on how college endowments and foundations can prepare for coming tax hikes

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Changes afoot

As the deck continues to be reshuffled at the federal level, tax changes are in the cards, although thankfully not as large as in the initial House proposal.

A shift in U.S. tax policy focusing on large private university endowments and foundation (E&F) assets takes effect in 2026. The new tiered excise tax—more punitive than the current rate for larger endowments—could have repercussions on net returns and long-term capital compounding.

Tax hikes

On July 4, 2025, President Trump signed the One Big Beautiful Bill into law. The bill includes legislation that reshapes the excise tax on net investment income for private university endowments.

Exhibit 1: Size Matters

Excise tax on net investment income for private university endowments

Endowment size by assets per student	Tax rate for 2026 and beyond
\$500,000 – \$750,000	1.4%
\$750,000 – \$2 million	4%
Above \$2 million	8%

This represents a significant departure from the current flat 1.4% excise tax for endowments over \$500,000 per student, applying to tax years beginning after Dec. 31, 2025.

How to soften the tax impact today

2025 is the final year under the lower flat rate. We believe impacted endowments should act now to reposition portfolios before the tiered tax regime takes effect. By doing so, they can accelerate the realization of investment gains, booking the net investment income in the current fiscal year with lower tax liability.

Steps to consider by asset class include:

Public equity

- **Accelerated gain realization:** Execute sell transactions, with offsetting purchases, to harvest unrealized gains in 2025.
- **Loss deferral:** Defer the realization of losses into 2026 to increase their future tax offset value.

Public fixed income

- **Basis reset:** Evaluate swapping or harvesting positions with embedded gains to reset tax basis under the lower 2025 rate.

Private funds and commingled vehicles

- **Round-trip trades:** Sell and reenter the same fund to lock in a basis step-up where possible.
- **ETF Transitions:** When feasible, evaluate swapping mutual fund positions for ETFs to delay gain realization or reduce distribution exposure.

Careful attention to trading costs, fund availability and reinvestment friction is essential. Institutions should also factor in wash sale rules and timing constraints.

5 Smart tax strategies for tomorrow

Under a steeper tax regime, institutions will need to shift from one-time tax management to ongoing structural optimization. This includes reconfiguring investments and modifying fund selection criteria. Tax overlay strategies can coordinate across asset classes to manage gain realization and implement tax-loss harvesting on an ongoing basis.

Steps to consider by asset class and account include:

Public equity enhancements

- **Convert passive to tax-managed:** Shift from index-only tracking to a separately managed direct indexing strategy with tax-loss harvesting. Tax alpha generated will offset liabilities in other parts of the portfolio, like fixed income interest or private asset distributions, reducing tax liability at the endowment level.
- **Tax overlay on active segregated accounts:** Integrate a tax overlay into a centrally managed account for active public equity investments. Tax overlay will balance realized gains, losses, wash sales and other tax considerations.

Fund investments: Tax efficiency and selection

- **Segregated accounts:** Opportunistically look to convert pooled funds into separately managed accounts to enable loss harvesting and timing control (passive equity).
- **Low-distribution funds:** Prioritize funds and managers with structural characteristics that limit capital gain or income realization over the holding period.
- **Exchange funds and 531 ETF Solutions:** Consider utilizing these investments for low-basis holdings, whether diversified or concentrated positions.

Prepare today

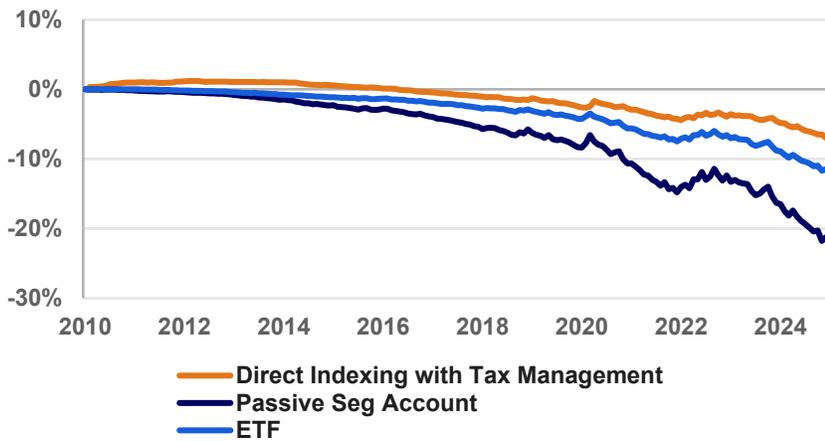
The most effective institutions will combine tactical execution in 2025 with structural innovation beyond 2026. We believe engaging investment consultants, legal counsel and tax advisors now will yield long-term advantages in a constrained environment.

Case study: The tax benefits of direct indexing and harvesting losses

By using direct indexing with tax-loss harvesting, a large private endowment could improve after tax performance in their U.S. equity beta allocation compared with a traditional passive separate account implementation or ETFs. Relative to a passive separate account or ETF implementation, after tax returns would improve by 0.17% annually and 0.07% annually, respectively.

Exhibit 2: Cumulative Tax Drag

Direct investing with tax management can significantly reduce tax drag, as shown during the 15-year period ending Dec. 31, 2024



Cumulative After-Tax Returns

- **592.06%** - Direct Indexing with Tax Management
- **557.07%** - Passive Separate Account
- **530.35%** - ETF

As of Dec. 31, 2024.

	Direct investing All cap	Passive separate account	Russell 3000 ETF
Pre-tax performance			
Pre-tax account – Gross	13.84%	13.61%	13.20%
Pre-tax benchmark	13.56%	13.56%	13.56%
Pre-tax excess return (with tax overlay)	0.27%	0.05%	-0.37%
After-tax performance			
After-tax account	13.77%	13.37%	13.06%
After-tax benchmark	13.32%	13.32%	113.32%
After-tax excess return (with tax overlay)	0.44%	0.05%	-0.27%
Tax alpha			
Tax alpha (after tax excess return—pre-tax excess return)	0.17%	0.00%	0.10%

Sources for both exhibits: Russell Investments, Bloomberg, Benchmark: Russell 3000. December 2009 to December 2024. Excise tax rate of 21%.

Where to next?



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