DATE: March 1, 2019  
TO: Finance and Budget Officers  
FROM: Sue Schmitt  
Controller  
SUBJECT: Briefing: Excise Tax Charge on Investment Pools and Funds

Dear Colleague,

As you know, the Tax Cuts and Jobs Act of 2017 introduced a 1.4% excise tax on “net investment income” of certain private colleges and universities. The tax became effective as of September 1, 2018 and applies to investment income (dividends, interest, rents, etc.) and realized gains (including gains on appreciated gift securities). This announcement provides important information regarding the charging of this tax and the timing of such charges. Certain provisions of the law require further clarification from the IRS. Accordingly, the procedures described below are subject to modification as further guidance is received.

General Approach

Investment income subject to the excise tax is generated either by assets held within investment pools or assets owned directly by School and Department funds. Consistent with principles of fund accounting, the tax will be charged directly to the pools or funds where the income-generating assets reside. An appropriate share of allowable expenses will be deducted from investment income prior to the application of the tax.

Merged Pool

In the case of the Merged Pool (MP), the Chief Financial Officer and Controller’s Office will establish an “accrual rate” for each fiscal year to best approximate the actual tax to be paid the following January. This amount will accrue against the MP share price, similar to how the share price reduces when expenses are incurred. For January – August 2019, the accrual rate will be $0.01 per share per month. As a result, the tax will slightly reduce the MP share price, but the payout to the shareholding funds will not be impacted at the fund level directly and will remain unchanged except as discussed below in the Section titled Gifts of Appreciated Stock and Real Estate. In practice, MP shareholders don’t need to take any action or plan any differently than they otherwise would.
Intermediate Pool

The fair market value of assets owned by the Intermediate Pool (I-Pool) will be reduced by the current and deferred excise tax payable, as well as the amount of investment expenses payable on a daily basis. The accrued tax liability will be reflected in the share price at which fund holders can transact. No tax is charged directly to the fund holders.

Specifically Invested Funds

These funds will be charged annually in January of each year at a rate of 1.4% on investment income and realized gains earned during the prior fiscal year. The first charge will be in January 2020. Stanford Management Company will manage reserves in the funds to provide liquidity for the tax charge.

Gifts of Appreciated Stock and Real Estate

Under the new tax law, the 1.4% excise tax will also apply to the gain realized on sale of appreciated gifts securities received from donors. This gain is calculated as the difference between donor’s basis (typically the original purchase cost) and the proceeds from the sale of the securities. How and when the tax will be charged to such gain will depend upon the type of gift as discussed below.

- **Endowment Gifts**
  The gifts received will be treated as gifts of endowment principal and be immediately available for investment in the MP. The 1.4% tax on the difference between net sale proceeds and the donor’s basis (if available, or zero, if not) will be charged in January 2020 (and for future years, the January following the fiscal year when the gift was made) against the corresponding endowment income fund. The effect of this will be a loss of approximately three months of payout for the fund. Please take this into account in budgeting this endowment income fund, so that there is adequate cash in the fund to meet the tax charge as well as budgeted expenses. The Controller’s Office will provide reports periodically showing tax liability due.

- **Gifts of Plant and Other Expendable Funds**
  The 1.4% tax on the difference between net sale proceeds and the donor’s basis (if determined, or zero, if not) will be charged in January 2020 (and for future years, the January following the fiscal year when the gift was made) against the fund that receives the gift. Please reserve adequate cash in the fund to meet the tax charge. The Controller’s Office will provide reports periodically showing tax liability due.

Endowment Income Funds Pool

Per current policy, the rate of return for the Endowment Income Funds Pool (EIFP) will be calculated at the end of the fiscal year. That rate will be reduced by 1.4% and the resulting rate will be used to calculate the amount credited to the EIFP deposits. Total EIFP income will be multiplied by 1.4% and that amount will be transferred from the EIFP to the accrued excise tax account at the end of each fiscal year.

Expendable Funds Pool
The Expendable Funds Pool (EFP) policy will not change. No additional charges will be made to the MP holdings of the EFP, other than those outlined in the “MP” section above. Realized taxable income from the direct investments of the EFP will be totaled and 1.4% of this amount will be transferred from the EFP to the accrued excise tax account at the end of each fiscal year.

If you have questions regarding this announcement, please contact Chris Canellos at (650)725-1732 or Supriya Pai at (650)498-6259.