



THE ATTORNEY GENERAL OF TEXAS

AUSTIN 11, TEXAS

JOHN BEN SHEPPERD
ATTORNEY GENERAL

December 31, 1956

Honorable Tom Sealy, Chairman
Board of Regents
University of Texas
P. O. Box 670
Midland, Texas

Letter Opinion No. MS-263

Re: The construction of the provisions of Article VII, Section 11a of the Constitution of Texas with reference to procedure to be followed by the University of Texas in the investment of the Permanent University Fund.

Dear Mr. Sealy:

Your request for an opinion presents questions relating to the investment of the Endowment or Permanent University Fund of the University of Texas, and are as follows:

1. In purchasing securities permitted by the provisions of Article 7, Section 11(a) of Texas, may payment be made before manual delivery of the securities?
2. Will the University of Texas be required to pay transfer taxes?
3. What is the proper treatment for gains and losses in the sale of securities under Article 7, Section 11(a) of the Constitution of Texas?

Your letter states the following facts as a predicate for the first question: The rules and regulations governing members of the principal stock exchanges require payment on the fourth business day following the purchase of securities. Under normal business conditions, two or three weeks may be required for the clearance, transfer and issuance of the new stock certificates. Your question is whether the University of Texas may make such payments, prior to delivery, without lending the credit of the State.

There can be no question of lending the credit of the State if the Board of Regents employs a dealer in securities (as those terms are defined in Article 579, V.C.S.) as agent to effect a particular transaction. In such a situation, the rule in

Hon. Tom Sealy, page 2 (MS-263)

Texas is clear -- title passes to the principal. 2 Tex. Juris., "Agency", Sections 139, 154 and 155. Confirmation of the order, sworn invoices, and documented vouchers or other documents used in the regular course of business, verified as required by statute, would necessarily be required at the time payment is made.

Your second question is whether the University of Texas is required to pay the excise tax on the sale or transfer of certificates of stock issued by a corporation.

Pursuant to the provisions of Article 8, Section 2, of the Constitution of Texas, the Legislature has provided that public property used for public purposes shall be exempt from taxation. Article 7150(4), V.C.S. Thus, the Permanent University Fund would not be liable for stock transfer taxes under the provisions of Article 7047m, V.C.S.

Under the Internal Revenue Code of 1954, the University of Texas would be required to pay the documentary stamp tax under 26 U.S.C.A., Section 4321 unless the security acquired is exempt under the provisions of 26 U.S.C.A., Section 4382.

If the transaction is effected in the State of New York, 10 Consol. Laws of New York, Tax Law, Section 270, would require the payment of the transfer tax.

A consideration of the provisions of Article 7, Sections 10, 11, 11(a), 12 and 15 of the Constitution of Texas, shows quite clearly that the only change in our Constitution affected by the adoption of Article 7, Section 11(a) was to increase the permissive investments of the Permanent University Fund. The sole purpose of the endowment or non-expendable fund is to produce revenue to maintain the institution endowed, and the new provision of the Constitution is merely to aid in the procurement of that objective by the broadening of the investment portfolio.

It is readily apparent that investments in diversified securities will result in gains and losses, and Article 7, Section 11(a) expressly accepts this principle in the adoption of the prudent man rule of the Texas Trust Act (Article 7425b-46, V.C.S.)

The question is whether these gains and losses should be charged against the principal or income account.

In State, ex rel, Attorney General v. Hatcher, State Treasurer, 115 Tex. 332, 281 S. W. 192, 194 (1926) the Supreme Court of Texas considered whether certain funds of the University of Texas should be credited to the Permanent or Available Fund, and said:

"It is provided in our Constitution that the 'proceeds' of the land which is gone shall become a part of the permanent fund. In other words, not only the realty, but the resulting personalty is a part of that fund. Of course, proceeds arising from an alienation or taking of land, or any portion thereof, is usually money or personalty. It was the intention of the framers of our fundamental law that this land, and each portion thereof, should always be in the permanent fund. It was foreseen that it might be best to sell it. In that event, it was expressly provided that the substitute for the land should take its place in the permanent fund."

That same constitutional provision (Article 7, Section 11) considered in the Hatcher case; supra, also expressly provides that the moneys received from the sale of lands, the grants, unlimited donations, and appropriations shall be received "into the Treasury of the State" and be invested in certain types of securities with the interest thereon being subject to appropriation for the purposes specified in Article 7, Section 10, of the Constitution.

When the endowment fund is used to purchase corporate securities, the principal of the investment will not lose its identity as a part of the Permanent University Fund, although the "interest and dividends received" shall become a part of the Available Fund. Article 7, Sections 11 and 11(a), Constitution of Texas. By the same token, upon the sale of the investment the amount realized must return to the Permanent University Fund.

With the above principles in view, your attention is directed to Chapter 519, Article V, Section 18(b), Acts of the 54th Legislature, 1955, which recognizes the publication of the American Council on Education as an authoritative work, College and University Business Administration; and directs the keeping of financial accounts in accordance with that manual. That work draws a distinction between endowment and annuity funds, and as to endowment funds (under the heading Basic Principles of Accounting) the following rule is announced (Volume 1, Page 16):

"Realized gains or losses on the sale of investments should be carried to the principal of the

Hon. Tom Sealy, page 4 (MS-263)

the funds involved, or to an appropriate reserve account for pooled investments. Gains from the sale of assets of this fund group do not constitute income."

Again, at page 92 of that same volume, we find the following:

"Gains and losses on disposition of endowment fund investments are principal transactions, not income or expense."

This opinion is restricted to the exact question which you have propounded, namely, the proper treatment of gains and losses on investments to be made under the provisions of Article 7, Section 11(a) of the Constitution of Texas. Accordingly, it should not be considered as a guide for any other state agency absent identical constitutional provisions.

Very truly yours,

JOHN BEN SHEPPERD
Attorney General

By *Elbert M. Morrow*
Elbert M. Morrow
Assistant

EMM-s

APPROVED:

W. V. Geppert
Reviewer

J. C. Davis, Jr.
Reviewer

Davis Grant
First Assistant

John Ben Shepperd
Attorney General