CONGRESS CONSIDERING LEGISLATION TO Change Payout Calculations

As sultry summer weather settles in on the nation's capital, temperatures are also rising over controversial provisions of a congressional proposal that would change how private foundations calculate their payout. Under current law, private foundations are required to spend a minimum of 5 percent of their net investment assets annually. H.R. 7, the Charitable Giving Act, introduced by Congressmen Roy Blunt (R-MO) and Harold Ford, Jr., (D-TN), would no longer permit private foundations to include salaries, rent, and other administrative expenses when counting payout. According to its supporters, the provision is intended to help charities through tough economic times by generating perhaps as much as $4.3 billion annually for nonprofits meeting urgent social needs. Opponents of the measure argue that it would eat into foundation endowments, ultimately reducing foundations' ability to have a significant impact on societal needs over time. This *Issue Focus* provides basic information on the legislation now under consideration and outlines the arguments on both sides.

THE LEGISLATION AND THE PROCESS

H.R. 7 is a multifaceted proposal with provisions affecting various aspects of tax policy relevant to the nonprofit sector, including distributions from individual retirement accounts to charities, charitable deductions for nonitemizers, and other issues. The two provisions of most interest to foundations are:

- a provision eliminating administrative expenses from qualifying distributions that may be counted toward the 5 percent payout requirement by private foundations; and
- a provision reducing the excise tax on private foundation net investment income from the current two-tiered system (2 percent/1 percent) to a flat 1 percent.

This legislation is now pending before the House Ways and Means Committee. It must be passed out of the committee and considered by the full House. The Senate has already passed a similar bill related to charitable issues (S. 476, often referred to as the Care Act of 2003), although this legislation does not include the two provisions described above. If the full House passes H.R. 7 (and floor action is expected, sometime early this summer), a conference committee will be appointed to iron out differences between the two bills. Opponents of the legislation could seek to eliminate the provisions at the committee level, during the full House consideration, or in conference.

ARGUMENTS IN FAVOR OF H.R. 7	ARGUMENTS AGAINST H.R. 7
Eliminating administrative expenses from payout will force foundations to increase the amount of money that goes out the door in grants, at a time when charities badly need additional support.	The level of societal need is so great that increasing foundation payout would only be a drop in the bucket in the short term and would erode the viability of charitable endowments over the long term.
Foundations spend too much money on administrative expenses such as salaries and rent. Recent news stories in California and New York provide clear examples of excessive compensation to foundation executives and trustees.	Studies by the Internal Revenue Service and others have concluded that private foundations are responsible stewards for their endowments. Abuses are isolated and should be punished through sanctions that are already permitted under the tax code, not by changing the rules for everyone.
Foundations should use their resources for grants. What charities need most is money.	Administrative expenses, such as technical assistance, communications, research, and convening, are legitimate tools for achieving philanthropic missions. They are an important complement to grants for many charities.

WHAT THEY'RE SAYING

H.R. 7's provision on administrative expenses is being supported by a bipartisan coalition of representatives as well as the National Council of Nonprofit Associations and the National Committee for Responsive Philanthropy, which has described the legislation as "modest and reasonable reform that would help charities with desperately needed new grantmaking while simultaneously safeguarding foundation perpetuity." This provision is opposed by the Council on Foundations; and the Foundation Executives Group, which includes officials from the Carnegie Corporation of New York, the Andrew W. Mellon Foundation, the Bill & Melinda Gates Foundation, and the William and Flora Hewlett Foundation. Independent Sector, while supporting many of the provisions of H.R. 7, has stated its opposition to the payout provision, noting that there is "no conclusive evidence that this proposal would produce the desired outcome of increasing resources to charitable nonprofits without undermining effective grantmaking and public accountability."

HOW WOULD HEALTH FOUNDATIONS BE AFFECTED?

Given the diversity of health philanthropy, it is difficult to gauge how health foundations would be affected if H.R. 7 became law. First, many foundations that fund in health are public charities and thus are not subject to the payout rules for private foundations. Second, health funders differ substantially in their strategies and existing payout practices. For example, as described in a recent article in *The Chronicle of Philanthropy*, The Robert Wood Johnson Foundation has administrative costs equaling 23.5 percent of its total grants and expenses, in part reflecting a strategy to use contracts with both businesses and nonprofit organizations to further many of its major health initiatives. By contrast, another of the nation's largest funders in health, the W.K. Kellogg Foundation, has administrative costs of 11.1 percent of total grants and expenses. Third, foundations that maintained previous grantmaking levels after the stock market decline may already have payouts in excess of 5 percent. In California, a review by the San Jose *Mercury News* of the 2001 tax returns of the state's 24 largest foundations, for example, found that 13 of them would still meet the 5 percent threshold if administrative expenses continued to be counted in the calculation.

RESOURCES

Want more information? Trying to decide how you can weigh in? The following organizations may provide the information you seek. Grantmakers In Health serves primarily as an information resource and, as such, does not take positions on policy issues, whether related to health or the nonprofit sector.

Council on Foundations, www.cof.org

COF has issued a legislative alert to its members and other foundations to communicate with members of the House of Representatives regarding H.R. 7. Its Web site includes talking points, summaries of the House and Senate bills, sample letters, an analysis of the National Committee for Responsive Philanthropy's study (see below), and contact information for members of the House and Senate committees with jurisdiction over tax matters.

National Committee on Responsive Philanthropy, www.ncrp.org

NCRP has posted an analysis of H.R. 7 on its Web site. The 10-page report, *Helping Charities, Sustaining Foundations*, outlines the organization's major points in support of the legislation. It is based on the organization's analysis of the spending patterns of the nation's 100 top private foundations.

ARTICLES

Eisenberg, Pablo, "Don't Cry for Thee, Foundations," *The Chronicle of Philanthropy*, May 29, 2003, p. 35.

Kramer, Mark, "Members of Congress Don't Understand What Good Grant Making Takes," *The Chronicle of Philanthropy*, May 29, 2003, p. 35.

Lipman, Harvey, and Ian Wilhelm, "Pressing Foundations to Give More: Controversial Proposal Could Produce Millions for Charity," *The Chronicle of Philanthropy*, May 29, 2003, p. 7.

Nalder, Eric, and John Boudreau, "How House Bill Would Affect 9 Top Foundations: Annual Giving Would Go Up by as Much as $35 Million," *Mercury News*, May 26, 2003.