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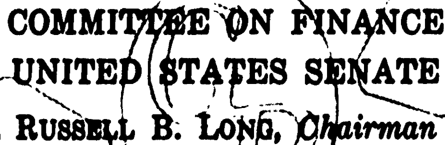
TAX REFORM ACT OF 1969

H.R. 13270

PART A—TESTIMONY TO BE RECEIVED THURSDAY, SEPTEMBER 18, 1969

PART B—ADDITIONAL STATEMENTS

(Topics: Charitable Contributions; Stock Dividends; Moving Expenses)



COMMITTEE ON FINANCE
UNITED STATES SENATE
RUSSELL B. LONG, *Chairman*

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S U M M A R Y

Testimony of the American Council on Education

Before the

Committee on Finance

United States Senate

September 18, 1969

The American Council on Education:

1. Supports the increase of the limitation on charitable contributions from 30 to 50 percent.

2. Endorses the proposal that donors of appreciated long term real and intangible property be entitled to deduct the full fair market value of the property withou including the unrealized appreciation in income. We see no reason why this incentive should not be extended to gifts of tangible personal property and future interests.

3. Opposes the treatment of unrealized appreciation of gift property in tax preference income and the inclusion of charitable contributions within the allocation of deductions.

4. Doubts whether the alleged abuses in gifts of remainder interests warrant the implementation of the charitable remainder trust concepts and suggests there is no reason for denial of a deduction for a traditional legal life estate.

5. Endorses the denial of deduction for gifts of property, such as fair rental value, but contends that the language may extend its coverage beyond Congressional intent.

6. Endorses "Clay-Brown" and suggests (1) limiting the statute pertaining to advertising revenue by exempt organizations and (2) certain modifications that the promise to pay an annuity is not a debt subjecting an institution to an unrelated business income tax.

7. Suggests that if the present unlimited deduction for contributions of estates or trusts is altered, the change should have no application to irrevocable life income and annuity gifts created prior to the enactment of the bill.

8. Recognizes that there may be a need for colleges and universities to file returns, but opposes making the name of donors or the amounts paid to highly compensated employees public information.

9. Opposes the 7 1/2 percent tax on foundation income and supports a supervisory fee. Entities associated with higher education should be excluded from the definition of and not made subject to provisions governing private foundations. We believe that restrictions on legislative activity of foundations will seriously endanger the making of grants to educational institutions.

10. Recognizes that colleges and universities have been dependent on tax exempt bonds and can support only those changes in the law that would not inhibit the ability of institutions to raise funds at low interest cost.

TAX REFORM (H.R. 13270)

STATEMENT OF

The American Council on Education

JOINED BY

The American Alumni Council

The American Association of Colleges for Teacher Education

The American Association for Higher Education

The American Association of Junior Colleges

The American Association of State Colleges and Universities

The American College Public Relations Association

The Association of American Colleges

The Association of American Universities

The Council of Protestant Colleges and Universities

The National Association of Independent Schools

The National Association of State Universities and Land-Grant Colleges

The National Catholic Education Association

September 18, 1969

TAX REFORM (H.R. 13270)

General Statement of

Logan Wilson, President

Representing the American Council on Education and Other Associations

Before the

Finance Committee

United States Senate

September 18, 1969

Mr. Chairman and members of the Committee: I am Logan Wilson, president of the American Council on Education, which numbers in its membership 1538 colleges and universities and associations of higher education. I am accompanied today by Professor Julian Levi of the University of Chicago, chairman of the Council's Committee on Taxation; President William Friday of the University of North Carolina; and President Landrum Bolling of Earlham College in Richmond, Indiana. The composition of this panel will suggest to you the importance of private philanthropic support to all institutions--public and private alike.

In compliance with the Committee's request that testimony be consolidated, a number of other associations are joining us in this statement. They are listed on the cover sheet.

This fall--1969--the United States Office of Education has estimated the enrollment of degree credit students in American colleges and universities at 7.1 million. The fact that 42 percent of all of American youth in their middle and late teens will enroll in a degree credit program in a college or university is the envy of every nation.

The financial burdens thus thrust upon higher education are, indeed, awesome. The United States Office of Education estimates total current expenditures for higher education in the 1967-68 academic year on the order of $15.3 billion. American colleges and universities have never been in more serious financial difficulties as they struggle with rising costs and increasing numbers of students. With remarkable bipartisan support, the Congress has passed many measures designed to provide Federal assistance to all our colleges and universities as they strive to meet these most extraordinary demands made upon them.

From its inception, antedating the formation of the Republic itself, American higher education has been dependent upon the generosity of voluntary support. Federal programs which often require university matching funds heighten, rather than diminish, the importance of voluntary support. The Council for Financial Aid to Education has reported that in that same academic year 1967-68 such voluntary support amounted to $1.57 billion. In other words, higher education relied on private philanthropy to provide 10 percent of its operating budget, and that 10 percent is what has kept our institutions solvent. State-controlled colleges and universities received almost 20 percent of this total support. The survival and quality of public, as well as private, higher education in this nation is dependent upon greatly increased voluntary support over the coming years.

We believe it is not only sound public policy but good economics for the Congress to do all in its power, through tax incentives, to increase and broaden voluntary support from the private sector. Nevertheless, we understand and agree that tax policies, which affect all citizens, should be scrutinized regularly in an effort to uncover abuses and to bring about greater equity.

While in our view general Federal tax policy, as true throughout history of the Internal Revenue Code, should provide an incentive for giving to higher education, we would exclude any result which would leave any donor with an overall profit. We would require that the result of his gift invariably be to decrease

his net worth and that higher education must not engage in transactions solely for the tax benefit of any donor.

Moreover, higher education and its friends must argue from fact rather than conjecture. Accordingly, the attention of the committee is called to two studies accompanying this statement--the first sponsored by the American Council on Education entitled Patterns of Giving to Higher Education, analysing approximately two and one-half million donor transactions resulting in gifts of $1,034,000,000 to higher education in the year 1962-63; the second sponsored by the American Alumni Council, the Council for Financial Aid to Education, and the National Association of Independent Schools entitled Voluntary Support of Education 1967-68. The findings of these studies as they bear upon the issues here presented will be referred to specifically.

It is in this spirit that we offer the following comments on several issues before you.

The Council, in testimony before the House Ways and Means Committee, supported and continues to support certain clear reforms. However -

Legislation presently before this Committee limits the right of the taxpayer to deduct the fair market value of appreciated property through application of allocation and limited tax preference restrictions. The findings of the American Council on Education and the Council for Financial Aid to Education studies are crucial in explaining our grave concern as to these sections.

Higher education is extraordinarily dependent on large gifts. The American Council on Education study of 1962-63 giving disclosed that of an aggregate 2,453,186 donor transactions accounting in total for $1,034,836,277 of support, 21,753 donor transactions of over $5,000 accounted for $774,881,482. Less than one percent of all donor transactions account for approximately 75 percent of all support (page 15).

Of that $1,034,836,277 of all voluntary support, $794,350,838 or 76.7 percent was received in the form of cash; $183,308,097 or 17.7 percent was received in the

form of securities; and $57,177,342 or 5.6 percent was received in the form of property (page 24).

Gifts of security and property are most often received from the individual donor and the average size of donor transactions is significantly greater in gifts of securities or property than cash (page 17).

The Council for Financial Aid to Education study for 1967-68 shows that individuals, alumni and non-alumni, account for more than 47 percent of all voluntary support (page 67). Moreover, the study concluded that "Alumni support now stands alone as the fastest growing and most stable source of voluntary contributions." (page 5).

Studies carried out by eighteen representative Pennsylvania colleges and universities disclose that in the three years commencing July 1, 1966, and ending June 30, 1969, an average of 40.6 percent of outright gifts received from individuals consisted of securities. The same pattern is repeated in state after state.

It is thus a fair statement that in the years ahead colleges and universities will be increasingly compelled to seek support from individual donors whose patterns of giving consist to a most significant degree in gifts of securities. These transactions are, of course, voluntary. They reflect the generosity and concern of the individual donor who ought to be immediately aware of the tax consequences of that generosity. Otherwise, the incentive cannot operate.

We are advised that allocation and limited tax preference restrictions as now proposed can actually lead in some circumstances to the imposition of additional taxes against the donor by reason of his having made a gift. While in future years credits for such tax payments may be carried forward, their utility depends on the continued life of the taxpayer and the contingencies of his financial position. Moreover, calculation of these reductions is inconceivably complex. We include in Appendix A an illustration. To those of the Committee and staff who read it we wish to give assurance that we are not engaging in ridicule or satire. We embarked on a serious enterprise in order to determine the effects of the proposed law. Our conclusion is that literally no institution and no donor

can come close to determining in advance the tax effect of a major gift. Without such determination it seems improbable that the gift will be made.

At best the practical effect will be to limit the tax incentive to a short few weeks at the end of the taxpayer's accounting tax year. Tax consequences, since they are related to tax preference income or allocation in any one year, may be markedly different in any one year as compared to another. Donors will tend to concentrate gifts in one year rather than another. Intelligent institutional financial planning will be gravely handicapped.

Moreover, as shown by the Council for Financial Aid to Education Report, approximately one-half of all funds raised by higher education are for capital purposes, often the result of campaigns fulfilled by pledges or subscriptions for future years. These pledges are viewed as moral, rather than legal, commitments. The complications of limited tax preference and allocation formulas will seriously jeopardize their collection.

Private Foundations

Section 4945 defines taxable expenditures made by private foundations and imposes a tax on the private foundation equal to 100 percent of such expenditure and upon the foundation manager equal to 50 percent of the expenditure. Taxable expenditures are defined as any amount paid or incurred by a private foundation to

"carry out propaganda or otherwise attempt to influence legislation" further defined as including but not limited to:

"(1) any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof and

"(2) any attempt to influence legislation through private communication with any member or employee of a legislative body or with any other person who may participate in the formulation of the legislation."

While Section 4945 attempts to exclude "non-partisan analysis or research" from the interdiction of the law, the broad language of the statute and the penalty imposed will, as a practical matter, eliminate foundation support of college and university activity so essential that the Congress and state legislatures have over and over again turned to higher education.

We are, of course, aware of many examples of such university service as will be called to your attention. One evident case, however, arises from work performed over many years by university law schools for the Commissioners of Uniform State Laws and for the Trustees of the American Law Institute. These law schools are uniquely qualified to perform these assignments which, while non-partisan, by their very nature are directed to the drafting and passage of uniform legislation over the nation to the end that national justice or economic growth be not impeded by state lines of jurisdiction. Almost invariably this work has been supported by private sources.

We are gravely concerned with several provisions in H.R. 13270 that pertain to life income gifts, and in the technical analysis that follows we make a number of recommendations concerning them.

We are also concerned with the definition of private foundations which would, we believe unintentionally, include a number of educational organizations within that category. Our recommendations for change are also included in the analysis that follows.

The Committee will be hearing directly from many public witnesses on the proposal to impose a partial tax through the LTP provision on income from tax-exempt bonds. We wish to point out that to the extent this proposal increases interest changes or decreases the marketability of such issues, colleges and universities, especially public institutions, will find it that much more expensive to borrow for the construction of facilities.

Thank you, Mr. Chairman, for giving us this opportunity to appear. Our panel will be happy to answer your questions.

STATEMENT OF THE AMERICAN COUNCIL ON EDUCATION

Technical Analysis and Proposals

A. LIMIT ON TAX PREFERENCE AND ALLOCATION OF DEDUCTIONS

I. Problem

The most damaging provisions of the House tax bill, insofar as gifts to colleges, churches, hospitals and other public entities, are those requiring inclusion of unrealized appreciation in gift property as a "tax preference" for the purpose of the limit on tax preference (LTP) (Section 301) and the allocation of deductions (Section 302). The proposals result in an indirect tax on the unrealized appreciation reducing the tax benefit of the contribution below the limitations otherwise imposed by the bill. For this reason alone, they could severely reduce the substantial gifts of major donors which play such an important role in the support of institutions of higher education, public and private. Moreover, the complicated computations required would affect a taxpayer's income not only in the year of gift but in later years and make the planning of such gifts difficult, if not impossible.

The limit on tax preference provides in effect for a minimum tax. Under this a taxpayer's preference income which escapes taxation cannot exceed his taxable income. Under the allocation of deductions, virtually all of an individual's itemized deductions must be allocated in part to preference income which may be received without imposition of either penalty.

Under other sections, the bill provides that an individual donor may deduct the fair market value of certain kinds of appreciated property (real and intangible (securities) capital assets) which have been held for more

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than 12 months without being required to include the unrealized appreciation in income provided the donation is to a church, college, hospital or public entity (as redefined). The inclusion of that unrealized appreciation in the computation of the minimum tax and the allocation of deductions is not consistent with these sections and inappropriate for the following reasons:

1. All of the other items of preference income represent actual income received by the taxpayer which escapes taxation either through exclusion (i.e., tax exempt municipal bond interest and the untaxed portion of long-term capital gains) or the granting of an offsetting unrealistic deduction (i.e., excess depletion, excess farm loss and excess depreciation).

2. By its nature, the appreciation in property so given is "unrealized" and not received by the donor but by the donee institution.

3. The donee institutions are limited to those clearly operating in the public interest as defined by Congress.

4. The inclusion of the unrealized appreciation as a tax preference for LTP and allocation of deductions actually represents a fourth limitation on the charitable contributions deduction. The first is the limitation itself (50 percent under the proposed bill). The second is the limitation on the gift of appreciated property (30 percent under the proposed bill). The third is the requirement that charitable contributions be allocated in part to tax preference income as proposed in the allocation of deductions section.

5. Said inclusion, in effect, represents a double limitation on deductions within the allocation of deductions proposal itself, the donor losing the benefit of his deduction (a) by being required to allocate any charitable contribution in part to all tax preference income and (b) by being required to allocate not only all of his charitable contributions but also all of his other itemized deductions in part to the unrealized appreciation in gift property.

6. The combination of LTP and AOD is such as to severely penalize the generous donor who may wish to make a gift of appreciated property with no intent of realizing on the full benefit of the deduction. For example, a donor who makes a gift of appreciated property which substantially exceeds his ordinary income (a not uncommon event) may in the year of the gift, as a result of the inclusion of unrealized appreciation in LTP and AOD, increase his taxable income two or three fold and his taxes in the initial year four, five or six fold. Although provision is made for recapture of a portion of this penalty tax in later years, the recapture will be entirely uncertain and dependent upon the unpredictable circumstances in those later years and indeed upon the taxpayer's very survival.

7. The inclusion of unrealized appreciation as a tax preference will discourage those major gifts by generous donors on which colleges, churches, hospitals and similar public entities are so dependent, not only because the benefit of the deduction will be seriously curtailed but also because of the complicated nature of the computation required. This results from the interdependence of factors, some of which are wholly

unrelated to the charitable contribution itself. No donor will be able to make plans for an orderly procedure with respect to the making of major gifts insofar as taxes are concerned since the benefit of the deduction will not be known until the very end of each tax year, if then. With respect to carryover gifts and satisfaction of pledges, this will be especially damaging. While it is demonstrably difficult for a donor to determine the effect of a gift in the year of contribution, it may well be impossible for him to estimate the effect of a contribution pledged for or carried over to a future year. In such case, the unknowns include not only the donor's future economic situation but the possible realization of other "preference income" (such as long-term capital gains), his other charitable commitments and even the likelihood of his survival

II. Proposal

That the unrealized appreciation in gift property be excluded from the definition of "tax preference" in both the limit on "tax preference" and the "allocation of deductions" through the deletion of Section 84(c)(1)(A) as added by Section 301(a) of the bill (page 166) and the renumbering of the subsequent subsections.

B. GIFT OF APPRECIATED PROPERTY

I. Problem

It is recognized that in certain limited instances a high-bracket donor of appreciated property which, if sold, would give rise to ordinary income or short-term capital gain may be in a better position financially as a result of having made a contribution than he would had he sold the property in question. For this reason, the provisions of the proposed bill which would require a donor of such property to limit his deduction to his tax basis in the property or include the unrealized appreciation as income if he elects to deduct the fair market value of the property have merit. Where the property is a capital asset which, if sold, would give rise to long-term capital gain, then the donor clearly departs irrevocably with an asset and the deduction recompenses him only in part for his loss. The encouragement of such gifts to colleges, churches and public entities as redefined would, therefore, clearly seem to be in the public interest. Indeed, the curtailment of this tax incentive might well be disastrous to the fund-raising activities of such charities operating within the public sphere. While it is imperative to retain this tax incentive as proposed in the present bill with respect to gifts of long-term appreciated real and intangible property, there seems no logical justification for excluding from this general rule gifts of tangible personal property and gifts of future interest in property.

Tangible Personal Property - The abuses with respect to the gifts of tangible personal property have been largely eliminated by other provisions of the bill or by administrative procedures within the Internal Revenue Service. Thus, under other provisions of the bill, collections of personal papers will produce ordinary income if sold as will paintings created by the donor himself. (Section 513 of the bill (pages 285 through 287).) The deduction for gifts by such a collector or creator will, therefore, be limited to the donor's tax basis or the donor will be required to include the unrealized appreciation in income.

In the past, justified concern has been expressed with respect to the valuation of art objects. This abuse has been curtailed or largely eliminated through an improved audit program and the creation of a special advisory group to assist the Commissioner of Internal Revenue. Indeed, the valuation problem will not be eliminated under the bill because the donor will be entitled to deduct the fair market value if he includes the increment in income.

The restrictive rule proposed by the bill could have a disastrous effect on generous gifts of works of art, manuscripts and the like to university museums, art galleries and libraries whose collections are dependent on such contributions.

Gifts of Future Interests - Donations of future interests have been of substantial value to churches, colleges, universities and hospitals. This method of giving antedates the tax laws and has been of special importance to small educational and charitable institutions which do not

have access to major donors. Insofar as a donor of modest means is concerned, this may be the only way in which he can make a substantial gift to the institution of his choice.

Traditionally, such gifts are made in the form of property - a home or farm which the donor retains for his life or securities - from which the donor realizes a sufficient income to protect himself or his family during lifetime, with an irrevocable commitment to public or charitable use thereafter. The limiting of the donor to his tax basis for the purpose of computing the gift or the requirement that he include the unrealized appreciation in his income would impose such a burden on these donors that they will be precluded from the making of such gifts. There seems no logical reason why the donor of such property should not be entitled to the same benefits as the donor who can afford to part irrevocably with an appreciated asset of substantial value.

II. Proposal

Section 170(e) as amended by Section 201(c) of the proposed bill would be amended by striking subsections (B) and (C) of subsection (2) and the last paragraph of subsection (2) with corresponding deletion of "(A)" at the beginning thereof. (Pages 123 and 124)

C. LIMITATION ON GIFTS BY INDIVIDUALS

I. Problem

Increase in Individual Limitation from 30 Percent to 50 Percent - The bill provides for an increase in the limitation on charitable contributions deduction from 30 to 50 percent for gifts to churches, educational institutions and public entities. While this will be of limited influence in encouraging gifts, the proposed increase should be approved.

Appreciated Property - The bill also proposes that there be a special limitation on the gift of appreciated property to 30 percent of the contribution base even though made to a college, church or hospital (with an appropriate carry forward). There seems to be little reason for this discrimination. In any event, the limitation should be not in terms of the value of the property but in terms of the unrealized appreciation which escapes taxation as a result of the gift to a qualified charity. It is to be noted that the 30 percent limitation on the unrealized appreciation will further limit donations by major donors.

II. Proposal

That subsection (J) of 170(b)(1) as added by Section 201(a) of the bill (page 116) be deleted or, if retained, the limitation therein should be expressed in terms of "the total deduction for that portion of the charitable contribution which is attributable to appreciation in the value of property not included in gross income shall not exceed 30 percent of the taxpayer's contribution base."

D. CHARITABLE REMAINDER TRUST

I. Problem

Under the bill, a deduction for the fair market value of a remainder interest for income, estate and gift tax purposes would be allowed only if the gift is made to a "charitable remainder annuity trust" or "charitable remainder unitrust." A "charitable remainder annuity trust" is one which requires payment of a sum certain annually for a term of years or the life of the person. A "charitable remainder unitrust" requires that a fixed percent of the net fair market value of the assets computed annually be paid not less than annually to the life tenant. (Section 170(h) added by Section 201(e) of the bill (pages 127, 128); Sections 2055(e)(2) and 2522(c)(2) added by Section 201(h) of the bill (pages 130-134).) In both cases the remainder must pass to the qualified donee institution or be held by the trust for its use. Under the bill, neither trust will be subject to tax on gains or undistributed income. (Section 664 as added by Section 201 of the bill (pages 135-137).)

This provision is traceable to a tentative decision of the Ways and Means Committee announced by Chairman Mills on May 27, 1969:

> "to adopt a provision under which the charitable contribution deduction would be recaptured in whole or in part where the investment policies of the trust - as between the income and the remainder beneficiaries - are not consistent with the assumptions on which the deduction was originally computed."

It is obvious that the Committee was not able to draft the provision contemplated and, in the alternative, adopted the unitrust concept originally

put forth in the so-called Surrey Report setting forth the recommendations of the prior Administration. Clearly, the purpose is to obviate the possibility that, through their investment policies, the life tenant may be benefited at the expense of the remainder interest passing to the charity.

Although the Surrey Report gave examples of situations under which a donor might obtain a charitable deduction based upon a remainder which would not in fact ultimately pass to the charitable remaindermen, the abuses thus specified are subject to correction under the present law either through imposition of ordinary local trust law concepts on the responsibility of the trustee or because the arrangement in fact constitutes a fraud of the tax laws. Further, although the charitable remainder trust concept as written into the law may curb the alleged abuse of improper investment policies, it is not clear that it will not create an opportunity for further abuses based upon the trust concepts as they apply to the taxation of beneficiaries receiving income therefrom.

The proposal would eliminate a deduction for the traditional life income gift, namely, a reservation of a life estate in real property with the property passing outright at the death of the tenant or tenants to the church or college. There can be no investment abuse in such an instance and, therefore, there should be no reason why the tax advantages of making such a gift should not be retained.

Whatever the merits of the "charitable remainder trust" concept, no change in the statute should affect the income, estate and gift tax

consequences of irrevocable transfers made prior to December 31, 1969.

The bill proposals would require that the deductions be determined on the basis of the value of the property transferred and the annual amount of percentage payable regardless of investment policies of the fiduciary. This means that the deduction will be the same regardless of the institution which is benefited or the amount of income realized by the fund. The concept has the disadvantage of making it possible, indeed likely, that the principal of the trust will be invaded to make the required payments. While this is proper with respect to the annuity trust, it may be improper insofar as the ordinary remainder trust is concerned, reacting to the disadvantage and detriment of the remaindermen by reason of the invasion of principal. Also, it should be made clear that in the case of either "trust" the benefit may be payable to one or more life tenants.

It is suggested that the abuses are not such as to require a drastic change in the manner of making ordinary life income or annuity gifts. Regardless, the incentive to fund such gifts with appreciated property should be retained. (See "Gift of Appreciated Property" above.)

If the Committee believes that the abuses are such as to require the placing of charitable remainder gifts in the straitjacket of the "charitable remainder trust" concept, then great care should be exercised to make certain that the application of this new concept and other concepts included in the

bill will not unfairly affect ordinary life income and annuity gifts heretofore created by executed will or irrevocable trust. The effective date with respect to deductibility for income tax purposes should be no earlier than taxable years beginning after December 31, 1970. Certainly, there is no reason to apply this rule retroactively to April 22, 1969, as proposed in the bill since even the announcement of May 27, 1969, contemplated an entirely different rule than that ultimately adopted by the Ways and Means Committee in its bill. By the same token, change in the estate tax deduction should only affect wills executed after December 31, 1969. With respect to irrevocable charitable remainder trusts created prior to December 31, 1969, the estate and gift tax deduction should be allowed under the rules in effect at the time of the creation of the trust.

Finally, as noted below, a trust will no longer be entitled to an unlimited deduction for an amount permanently set aside as under present law. This rule should not be applicable with respect to irrevocable life income or annuity gifts created prior to December 31, 1969, since the burden of such a tax, as applied to capital gains realized by such trusts will be borne almost entirely by the charitable remaindermen.

II. Proposal

1. Amend subsection (2) of Section 664(d) as added by Section 201(i) (page 137) by striking "and" at the end of the subparagraph (A) and substituting in its place "or", by relettering subparagraph "(B)" as subparagraph "(C)" and by substituting after subparagraph (A) the following:

"(B) From which the transferor retains a legal life estate in real property."

2. Amend subsections (A) of subsections (1) and (2) of subsection (d) of Section 664 as included in Section 201(i) (pages 136, 137) by adding in each case after the words "a person" "or persons" and modify the remainder of the section accordingly.

3. Make it clear in the legislative history that the fixed percentage may be different for each year provided the differing percentages are established in the instrument at the outset.

4. Amend subsection (A) of Section 664(d)(2) as included in Section 201(i) by adding after the words "valued annually" "(or a fixed percentage of the net fair market value of its assets, valued annually or the net income, whichever is the lesser)." (The legislative history should make it clear that the deduction shall be computed on the assumption that the fixed percentage will be paid. It should be clear that this is an alternative which is available to the donor and donee institution.)

Effective Dates

1. Subsection (5) of Section 201(j) (page 138) shall be amended to provide that "The amendment made by subsection (e) shall apply to a transfer in trust made after December 31, 1969."

2. Subsection (A) of paragraph 7 of Section 201(j) (pages 137,138) shall be amended to provide that "The amendment made to subparagraph (2) of Section 2055(e) by subparagraph (1) of Section 201(h) shall apply with respect to irrevocable transfers in trust made after December 31, 1969, and wills of decedents executed after December 31, 1969."

3. Subparagraph (B) of subparagraph (7) of Section 201(j) (page 139) shall be amended to provide that "The amendment made to subparagraph (2)(A) of Section 2522(c) as amended by subsection (3) of Section 201(h) shall apply with respect to gifts made after December 31, 1969."

4. Subparagraph (8) of Section 201(j) (page 139) shall be amended to provide that "The amendment of subsection (i) shall apply to transfers in trust made after December 31, 1969."

5. Subparagraph (6) of Section 201(j) (page 138) shall be amended to provide "The amendment made by subsection (f) shall apply to amounts paid, permanently set aside or to be used for a charitable purpose after December 31, 1969, provided that this amendment shall not apply with respect to a trust created by an irrevocable transfer prior to December 31, 1970."

E. COMMON TRUST FUND - COMMINGLED INVESTMENT FUND MAINTAINED BY ONE OR MORE COLLEGES OR UNIVERSITIES

1. Problem

For a number of years the Internal Revenue Service has questioned whether common investment of life income and annuity gift funds received by colleges, universities and similar entities, either with the endowment fund of the exempt entity or in a separate pool, may constitute an association taxable as a corporation under IRC Section 7701(a)(3) and Regulations 301.7701-2. In certain instances it has suggested that the same rule should apply with respect to a common endowment investment fund maintained by more than one college or university. The position of the Service is apparently based in large measure on the enactment of a special provision with respect to the common trust funds of banks. (Section 584)

Many life income and annuity gifts are relatively small and the only reasonable procedure with respect to investment is to commingle them either with the endowment fund of the institution or in a separate pool maintained for such purpose. The institution has a vested interest as remainderman of the property or indeed may be the legal owner of the property itself, having incurred only a contractual obligation to pay income or a fixed amount to the life tenant. It is difficult to believe that the Government has any interest in preventing the commingling of such funds for investment purposes.

By the same token, there seems every reason to encourage colleges and universities, particularly small institutions, to commingle their funds for investment purposes in order to have the advantages of a balanced

portfolio, which are now available only to institutions with substantial endowments.

Regardless of the merits of the Internal Revenue Service position, the implied threat to rule that such entities are taxable as corporations deters educational institutions from following reasonable and appropriate investment practices which the Congress should encourage. It is suggested that the Code be amended to make it clear that the common investment of life income and annuity gift funds and charitable remainder trust funds or the creation of a common investment pool by more than one college or university does not give rise to an "association" taxable as a corporation.

II. Proposal

That Section 501 be amended by adding thereto the following subsection (f) and that existing subsection (f) be renumbered as subsection (g):

"(f) Common Trust Funds -

"(A) Definition - For the purpose of this subtitle the term 'common trust fund' means a fund maintained by one or more organizations described in section 170(b)(1)(B) exclusively for the collective investment and reinvestment of moneys and property contributed to one or more of the participating institutions, whether or not all or a portion of said moneys and property is subject to the obligation on the part of one or more of the participating institutions to pay either an income for life or an annuity or to make payments under a charitable remainder annuity trust or charitable remainder unitrust as defined in section 664(d).

"(B) Taxation of Common Trust Fund - A common trust fund shall not be subject to taxation under this chapter and, for purposes of this chapter, shall not be considered a corporation."

F. CHARITABLE DEDUCTION FOR THE RIGHT TO USE PROPERTY

I. Problem

In the tentative decision announced May 27 and the legislative history, the Ways and Means Committee indicated a determination to disallow a charitable deduction for the contribution to a charity of the right to use property or, in other words, the fair rental value. The bill (Section 201(a)(3)) would add subsection (8) to IRC Section 170(b), denying a deduction for a charitable contribution for "less than (a taxpayer's) entire interest in property other than through a charitable remainder trust", stating "that a contribution by a taxpayer of the right to use property shall be treated as a charitable contribution of less than a taxpayer's entire interest in said property." The provision goes far beyond the stated intention of the drafters which the Committee explained was to deny to a donor the "double benefit (of) giving a charity the right to use property which he owns for a given period of time." (H.R. 91-413 (Part 7) (page 57).) It, apparently, would result in denial of deduction for a partial interest in property, such as a fractional interest, as well as for a legal estate in property, such as a remainder after life estate. There seems no reason why the provision should not be limited to the denial of a deduction for the use or fair rental value of property.

II. Proposal

Subsection (8) of Section 170(b) as added by Section 201(a)(3) (page 121) should be amended to read:

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"No deduction shall be allowed under this section for a charitable contribution by a taxpayer of a right to use property."

G. CHARITABLE CONTRIBUTIONS OF ESTATES OR TRUSTS

I. Problem

Under Section 642(c), an estate or trust is granted an unlimited deduction for amounts "paid or permanently set aside" for charitable purposes. With the apparent purpose of requiring a current benefit to charity where a deduction is involved, the bill proposes that a deduction be available only for amounts "paid" during the taxable year or within the following taxable year if the fiduciary elects to credit the payment to the prior year. (Section 201(f), pages 128-129) There seems no reason for the application of this rule to estates where, under the present Code and regulations, termination and, therefore, ultimate distribution is required at the earliest possible date. With respect to irrevocable trusts created prior to the effective date of the Act as proposed (or January 1, 1970, as suggested herein), the rule should not apply. As indicated above, this has special application to ordinary life income gifts where the donor has irrevocably committed his property in a trust for tax purposes, the income of which is to be paid to a life tenant or tenants and the remainder of which is to pass outright to the charity. By their nature, these trusts cannot be amended. If the proposed change is made applicable to "amounts paid, permanently set aside or to be used for charitable purposes after the date of enactment of this Act", then gains realized from the sale of any assets during the term of the trust subsequent to that date will become taxable. Almost the entire burden of this tax will be borne by the charitable remaindermen. For this reason, the

rules in effect at the time of the creation of the trust should be retained and the gains should not be taxed. Relief provisions should be included for situations where except for circumstances beyond the control of either the fiduciary or grantor, the payment must be postponed, such as in the case of a tax dispute or legal dispute as to the terms of the trust.

II. Proposal

1. See subparagraph 5 under "Effective Date" proposals with respect to charitable remainder trusts.

2. IRC Section 642(c), as amended by Section 201(f) of the bill, should be amended by striking the words "estate or" from the first line and adding at the end thereof "In the case of an estate, there shall be allowed as a deduction in computing its taxable income (in lieu of deductions allowed under Section 170(a) relating to charitable contributions and gifts) any amount of gross income without limitation which, pursuant to the terms of the governing instrument, is during the taxable year paid or permanently set aside for a purpose specified in Section 170(c)."

3. The conforming amendments of subsection (2) should be adjusted accordingly and a special provision should be included with respect to the allowance of the deduction where the trust is prohibited from making the distribution under circumstances beyond the control of the grantor or fiduciary.

H. FOUNDATIONS

1. Tax on Foundation Income

I. Problem

The bill proposes a 7-1/2 percent tax on foundation income. It would appear that any "tax" imposed on private foundations will actually be a burden borne by the beneficiary organizations to whom the required distributions must be made. Thus, the tax would appear to be punitive in nature and serving no public purpose.

It is recognized that the activities of some private foundations are such as to require that the Internal Revenue Service conduct continual and extensive audit and review of the receipts and expenditures of all. It is, therefore, appropriate to suggest that the private foundations be required to pay a registration or audit fee which will provide the Treasury with a sum sufficient to cover the expenses of said review. This should be a fee and not a tax. In the first place, the tax, although modest, is subject to increase. Second, if a tax is imposed by the Federal Government, then the states will seek to impose a similar levy. Indeed, in the case of some states, this will be automatic since their laws are dependent upon the Federal statutes.

II. Proposal

A "supervisory fee" should be imposed on "private foundations" which is sufficient to provide revenue to cover the costs of audit and supervision.

2. Definition

I. Problem

A serious problem is presented because of the approach taken by the Ways and Means Committee with respect to the definition of private foundations. Instead of attempting to define a "private foundation" as such, the Committee originally defined a "private foundation" as any 501(c)(3) organization except a church, college, hospital and publicly supported and operated entity. It was obvious that such a definition would bring within the purview of the "private foundation" provisions many entities, including those associated with colleges and universities, which should not be subject to the strictures of the bill. Accordingly, two additional exceptions were included in an attempt to exclude from the definition of "private foundation" entities which are in fact organized, operated and controlled in the public interest. One is based upon an established relationship between a foundation and one or more churches, colleges, hospitals or public entities. The other is based in the main, on the receipt of funds from the public. In both cases, restrictions are imposed to make sure that such entities are not in fact controlled directly or indirectly be interested individuals ("disqualifed persons").

It is apparent that these definitions are not sufficiently broad as to encompass all those entities which should not be treated as private foundations. More important, there remains considerable doubt as to the status under these proposals of many entities which are organized and operated to

carry out the functions of colleges and universities, such as joint ventures (encouraged by Federal and state governments), entities which are separately organized under Section 501(c)(3) because of the problems of state law (particularly as they affect public institutions of higher education) and associations of colleges and universities. Since the nature of such exempt entities is infinitely varied, the expansion of these definitions must in fact be on a piecemeal basis. However, several comments should be made with respect to the expanded definition as included in the bill:

a. Subsection (3) of Section 509(a) as added by Section 101(a) of the bill (pages 15 through 17) excludes from the definition of "private foundation":

"(3) an organization which --

"(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more organizations described in paragraph (1) or (2),

"(B) is operated, supervised, or controlled by one or more organizations, or in connection with one organization, described in paragraph (1) or (2), and

"(C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in paragraph (1) or (2); and"

It was originally proposed that (A) and (B) be in the conjunctive, the limitation of subsection (C), preventing direct or indirect control by disqualified persons. "(C)" appears to eliminate the

problem which concerned the Committee the most, namely, the possibility that an organization directly related to one or more colleges or universities or similar exempt entities might still be under the "control" of an individual or his family or related parties. The legislative history makes it clear that an organization, to be entitled to exclusion under this section, must meet the tests of (A), (B) and (C). If this is so, then it becomes important to examine carefully the provisions of (A) and (B).

With respect to subparagraph (A), the word "exclusively" is traceable to the basic exemption provision. It is argued that under this provision the word does not actually mean exclusively but "primarily." It is suggested that the word "primarily" should be substituted for "exclusively" if this is what is intended. Such an amendment is clearly appropriate in view of the fact that many of the organizations which should be excluded from the definition of private foundation under this section do have certain minimal activities which might remove them from the purview of this section if the word "exclusively" is narrowly interpreted. For example, many associations of colleges and universities have followed the practice of admitting to associate or similar membership other 501(c)(3) organizations which serve in one way or another the purposes of higher education. Some of these 501(c)(3) associates are "private foundations" within the meaning of the bill. It might

be argued that such an association of colleges and universities is not operated "exclusively" for the benefit of its controlling member institutions.

Secondly, there seems no reason whatsoever to limit "in connection with" to one organization. If an institution must meet the tests of both (A) and (B), then (B) should read "in connection with one or more organizations described in paragraph (1) or (2)." If an institution is organized primarily for the benefit of a church, college or public entity and is operated, supervised or controlled by or in connection with one or more such public entities, then it should not be treated as a "private foundation" if, in fact, it is neither controlled either directly or indirectly by a "disqualified person or persons."

b. The provisions of subsection (2) of the same section are unnecessarily restrictive as regards the source of public support. To a limited extent there is no reason why gifts of disqualified persons should not count in determining the one-third support which indicates broad public interest. There also seems no reason to penalize a foundation which otherwise meets the test of "broadly supported organizations" because it is well endowed and, therefore, has a substantial gross investment income, particularly if it is made clear as in the case of (3) that such an organization is not controlled directly or indirectly by a "disqualified person."

There are many organizations which, for one reason or another, may not be able to qualify for exclusion from the definition of private foundation without a modification of their governing instruments or adjustment of their method of operation. The statute should encourage such entities to operate in the public sphere by meeting the tests which qualify them for exclusion. Regardless of the merits of the organization and its real purposes and activities, if it was a "private foundation for its last taxable year ending before May 27, 1969," it will be treated as such unless its status is terminated under Section 508 with all the penalties and taxes imposed by Section 507. This is entirely inconsistent with the general purposes of the private foundation provisions. Indeed, it is inconsistent with the provisions which grant "private foundations" at least until the beginning of 1972 to modify their charters in such a way as to meet the new rules established by the statute. Since in most cases the changes will be of form rather than of substance, a transition period should be afforded within which an organization can adjust itself to come within the definition of those institutions which are not private foundations within the meaning of Section 509.

II. Proposal

1. Subsection (A) of subparagraph (3) of Section 509(a) as added by Section 101(a) (page 16) of the bill should be amended by deleting the word "exclusively" and substituting in its place the word "primarily."

2. Subsection (B) of subsection (3) of Section 509(a) as added by Section 101(a) of the bill (page 16) should be amended to read as follows:

"is operated, supervised, or controlled by or in connection with one or more organizations described in paragraph (1) or (2)."

3. Subparagraph (2) of Section 509(a) as added by Section 101(a) of the bill (pages 15 and 16) should be amended in accordance with the recommendations made above and in the light of special circumstances to be brought to the attention of the Committee.

4. Subsection (b) of Section 509 as added by Section 101(a) of the bill (pages 16 and 17) should be amended to read:

> "If an organization is a private foundation (within the meaning of subsection (a)) for its last taxable year ended before January 1, 1972, such organization shall for the purposes of this title be treated as a private foundation for each succeeding taxable year (1) until it is determined that the organization is no longer a private foundation (within the meaning of subsection (a)) in such manner as the Secretary or his delegate may by regulations prescribe or (2) unless its status is terminated under Section 508."

3. Restrictions on Grants to Colleges, Churches, Hospitals and Similar Exempt Entities

I. Problem

The bill as proposed imposes severe penalties not only on private foundations but on any foundation manager with respect to the making of a "taxable expenditure." Under the bill, a taxable expenditure means any expense "paid or incurred by a private foundation (1) to carry out propaganda or otherwise attempt to influence legislation, (2) to influence the outcome of any public election (including voter registration drives carried on by or for such foundation)." (Section 4945(b) as added by Section 101(b) of the bill (page 44).) A further subsection provides that "for the purposes of subparagraoh (1) (see above) taxable expenditure includes, but is not limited to, (1) any attempt to influence legislation through an attempt to affect the opinion of the general public or any segment thereof and (2) any attempt to influence legislation through private communication with any member or employee of a legislative body or with any other person who may participate in the formulation of legislation, other than through making available the results of nonpartisan analysis and research." (Section 4945(c) as added by Section 101(b) of the bill (page 45).)

Although the legislative history indicates a narrow purpose, the statute, as can be seen, is extremely broad. Any direct or indirect activity might result in the imposition of severe penalties to the foundation and/or its trustees or officers. Colleges, universities and their

related exempt entities are the recipients of many grants which result in reports and recommendations which could be considered to come within the purview of these broad provisions. The support of private foundations is essential to these clearly educational activities of colleges, universities and similar entities. As a result of the restriction, private foundations will be prohibited from making perfectly legitimate grants to such entities operating in the public sphere because of the fear of the imposition of penalties through the activities and reports of the recipient grantee organizations.

Private foundations should be free to make grants to such public entities without the fear of the imposition of penalties on the foundations and their managers. This is consistent with other provisions of the same subsection which permit grants to such organizations without the imposition of "expenditure responsibility" (Sections 509(b)(4) and 4945(b)(4) as added by Section 101(b) of the bill (page 44)) and individual grants which "constitute a fellowship or scholarship at an educational institution described in Section 170(b)(1)(B)" without specific requirement that the grantor demonstrate that the purpose of the grant is to "achieve a specific object, produce a report or other similar product or improve or enhance a literary, artistic, musical, scientific or other similar capacity skill or talent." (Section 4945(e) as added by Section 101(b) (pages 46 and 47). Section 4945(b)(3) of the same provision (page 44).)

II. Proposal

Subparagraph (b) of Section 4945 added by Section 101(b) of the bill (page 44) should be amended by adding the following subsection (6):

> "Paragraphs (1) and (2) of this subsection shall not apply with respect to a grant to an organization described in (1), (2) or (3) of Section 509(a)."

I. <u>UNRELATED BUSINESS - CLAY BROWN BILL</u>

I. Problem

The bill includes a section which would enact the so-called Clay Brown Bill, extending its application to virtually all nonprofit institutions, including churches. Under this, such entities would be taxed on their "unrelated debt financed income" - in other words, income from investments in real, personal or other property traceable, directly or indirectly to borrowed funds. It is obvious that the attempt to relate investments to borrowing will present the greatest difficulty from an administrative point of view. Nonetheless, the bill as modified through various drafts has been endorsed by the colleges and universities through representative organizations. It retains certain provisions which were added at their request, including a provision which would in effect suspend the tax with respect to real property acquired by an institution with borrowed funds for its exempt purposes if the real property is actually reduced to use by the college or university for its exempt functions within ten years.

One special problem is presented in connection with the definition of "obligation." At the request of certain organizations, the bill made it clear that the promise by an institution to pay an annuity would not in itself constitute a "debt" for the purposes of the imposition of the statute. Since life income and annuity gifts have traditionally been funded by property, the statute should also make it clear that the promise

to pay an income for life will not constitute a debt. On the assumption that the "charitable remainder trust" concept will be retained in the bill and that Congress will recognize the appropriateness of funding such gifts with appreciated property, it is suggested that the section dealing with annuities be amended to make it clear that the acceptance of a "charitable remainder trust" gift will not be considered to give rise to a debt obligation subjecting the institution to an unrelated business tax by reason of the funding of the charitable remainder gift with property, whether appreciated or not.

II. Proposal

Subsection (5) of Section 514(c) as added by Section 121(d) of the bill (pages 103 and 104) should be amended by deleting the whole thereof and substituting in its place the following:

> "(5) CHARITABLE REMAINDER TRUSTS.--The term 'acquisition indebtedness' does not include an obligation to make payments under charitable remainder trusts as provided in Section 664."

(The legislative history should make it clear that property received under life income and annuity gifts heretofore created will not be affected by the provision.)

J. UNRELATED BUSINESS - TAXATION OF ADVERTISING REVENUE

I. Problem

In an obscure provision of the bill (Section 121(c)), there is added to Section 513 a new subsection (c) entitled "advertising activities." This is apparently intended to give statutory support to the regulations which imposed the unrelated business tax on the advertising revenue received by an exempt organization in connection with publications, radio stations or other media. The provision, however, is stated in general terms which may have application well beyond the concept of taxation of advertising revenue proposed in the regulations. It states:

> "An activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may or may not be related to the exempt purposes of the organization."

This rule would apply with respect to "any activity which is carried on for the production of income from the sale of goods or performance of services." The provision is so vague as to permit application of the unrelated income tax to integral parts of a single activity solely on the basis of return of income and without application of the general concepts with respect to unrelated trade or business. The provision should be narrowly confined to the provisions of the regulations. It is to be noted that, under the present regulations, an exempt publication which is published at a loss would not be subject to the tax. Such an interpretation of the proposed statute might not be warranted.

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K. INCOME TAX RETURNS

I. Problem

Under Section 101(d) of the bill subsection (a) of Section 6033 would be amended to remove the exemption from filing returns which now obtains in the case of certain organizations, including churches and colleges and universities. Thus, colleges and universities would be subject to the same reporting requirements that now apply to all 501 (c)(3) organizations unless the Secretary determines that "such filing is not necessary to the efficient administration of the Internal Revenue laws." (Pages 57 through 60) If the Committee deems it necessary that colleges and universities and similar organizations file returns, it should not impose upon such entities the same requirements with respect to reporting as are imposed upon private foundations. In particular, such entities should not be required to make public the additional data which is now to be required of private foundations, namely, the names of substantial contributors and the compensation of trustees and highly compensated employees. The publication of such data could seriously affect the fund raising activities and operations of such entities without any real benefit accruing to the public.

Under Section 101(d)(2) of the bill all 501(c)(3) organizations would have to report the "names and addresses of all substantial contributors" and the "compensation and other payments made * * * to 'foundation managers (trustees and the like) and highly compensated employees.'" The relevance of such information insofar as "private foundations" are

concerned is clear. There seems to be no purpose in requiring churches, colleges, hospitals and similar public entities to include such information in the returns to be filed by them. The requirement that such information be made public under Section 6104 could be very detrimental not only to the operation of such entities but also to their fund raising activities. While it is appropriate to talk in terms of "highly compensated employees" of private foundations, the term has little or no meaning if used in connection with a college or university. Publication of the names of the substantial contributors (presumably those making gifts of more than $5,000) would deter such gifts since such donors are notably reluctant to have such information made available to the public for no other reason than the demands of other organizations. It is suggested that the increased reporting requirements not apply in the case of institutions which are not "private foundations" within the meaning of the new bill.

II. Proposal

1. Subparagraph (2) of Section 101(d) of the bill (page 58) be amended by deleting subparagraph (C).

2. Subparagraph (d) of Section 101 of the bill be amended by renumbering subparagraph "(3)" as subparagraph "(4)" and inserting as subparagraph (3) the following:

> "(3) Section 6033 is amended by adding the following:
>
> "(C) Certain organizations described in Section 501(c)(3) (other than organizations described in 509(a)(1), (2) or (3)). Every organization described in Section 501(c)(3) (other than an organization described in Section 509(a)(1), (2) or (3)) which is subject to the

requirements of subsection (a) shall furnish annually additional information at such time and in such manner as the Secretary or his delegate may by forms or regulations prescribe, setting forth:

"(1) the total of the contributions and gifts received by it during the year, and the names and addresses of all substantial contributions,

"(2) the names and addresses of its foundation managers (within the meaning of section 4946(b)(1)) and highly compensated employees, and

"(3) the compensation and other payments made during the year to each individual described in paragraph (2)."

L. TAX EXEMPT MUNICIPAL BONDS

I. Problem

State institutions of higher learning have for many years been dependent on the issuance of tax exempt bonds for the financing of dormitories and all kinds of facilities. The issuance of similar bonds by state authorities has played an increasingly important role in the financing of dormitories and educational facilities at private institutions. Any change in the tax law which would materially affect this source of financing could be extremely detrimental to the future of all institutions of higher learning, public and private.

Under the bill, individuals who would be indirectly taxed on their exempt income to the extent that such income is included in computing the "Limit on Tax Preference" and the "Allocation of Deductions" provisions. After a ten-year transitional period, all interest on otherwise exempt obligations would be included for the purposes of computing the "Limit on Tax Preference." After a similar ten-year transitional period, interest on all Government obligations issued after July 12, 1969, would be taken into account for the purposes of computing the "Allocation of Deductions." (The Administration is opposed to the inclusion of tax exempt interest on state and local bonds as "preference income" for the purposes of the "Limit on Tax Preference" in part because of Constitutional objections.) Under the bill, corporations, including banks, would not be subject to a direct or indirect tax with respect to tax exempt state and municipal bond interest.

Under Sections 601 and 602 of the bill (pages 317 through 321), states and municipalities would be encouraged to elect to issue fully taxable bonds in lieu of bonds, the interest of which is exempt from Federal income tax under Section 103. Under Section 602, the Federal Government would provide the state instrumentality with an interest subsidy of a fixed percent of the interest yield on each issue of obligations with respect to which such an election is made. The subsidy would be not less than 30 percent nor more than 40 percent until 1975 and not less than 25 percent nor more than 40 percent thereafter. The interest subsidy percentage would be established on a regular basis by the Secretary of the Treasury before each calendar quarter to which it applies.

II. Proposal

It is difficult, if not impossible, to estimate the effect of either the bill or the Administration proposal on the capacity of colleges and universities, public and private, to finance essential dormitories and facilities through the issuance of tax exempt bonds or, in the alternative, Federally subsidized bonds. However, any change in the law with respect to the exemption should be made only if the Committee is satisfied that it will not inhibit the ability of educational institutions to raise such funds at low interest cost.

APPLICATION OF THE LIMIT ON TAX PREFERENCES TO CHARITABLE GIFTS OF APPRECIATED PROPERTY

This memorandum deals with the calculations required by the Tax Reform Act of 1969 as passed by the House (H.R. 13270) on August 7, 1969 (the Bill) with regard to (i) application of the "limit on tax preferences (LTP) to gifts of appreciated property to charity and (ii) the allocation of charitable deductions.

Section 301(a) of the Bill adds a new Section 84 to the Internal Revenue Code of 1954 (IRC) listing five "items of tax preference" (Sec. 84(c)(1)), as follows:

(i) charitable contributions of appreciated property;

(ii) the excess of accelerated over straight-line depreciation;

(iii) interest on certain governmental obligations otherwise exempt from taxes;

(iv) certain excess farm losses;

(v) and the 1/2 of long term capital gains deductible from gross income.

These items of tax preference are to be added to the taxpayer's adjusted gross income (computed without regard to LTP) and one-half of this sum then establishes the taxpayer's "limit on tax preference" (LTP) except that in no event will this limit be less than $10,000. (Section 84(b) and (d) of IRC). To the extent the sum of the "items of tax preference" exceed the "limit on tax preference" the excess is treated as a "disallowed tax preference" and is included in the taxpayer's gross income (Section 84(a), (b) of IRC). The amount so included is to be considered derived proportionately from each "item of tax preference" (Section 84(e) of IRC), while the total of tax preferences up to the "limit," are denominated "allowable tax preferences."

However, not all of the appreciation in property donated to charity must be treated as a "item of tax preference" in the year of gift. It is only that part of the appreciation that is equal to:

> the amount of the deduction (determined without regard to Section 277) for charitable contributions under Section 170 or 642(c) allowable for the taxable year . . . (Section 84(c)(1)(A)).

Thus, before it can be determined how much of the appreciation given to charity is "preferential," it is necessary to ascertain the amount of the deduction to which the gift gives rise. In this respect, the parenthetical phrase -- "determined without regard to Section 277" -- is important. Section 277 is a new provision in the IRC (Section 302(a) of the Bill) providing for the allocation of certain deductions, including charitable deductions between the taxpayer's adjusted gross income (i.e. income subject to tax) and his allowable tax preferences (i.e. exempt income or

deductions giving rise to exempt income). By by-passing the allocation calculation, the Bill has the effect of rendering all of the appreciation given to charity within the Section 170 percentage ceiling on charitable deductions as a "item of tax preference," even though the taxpayer may not be entitled to deduct all of that appreciation because of the allocation requirement. This would seem to be an important conceptual error in the Bill.

Leaving aside this problem of the allocation by-pass, the first step in determining how much of a gift of appreciation to charity is preferential is to ascertain how much of the appreciation is potentially deductible under the Section 170 ceiling on deductions. Section 170(a) of the IRC will remain unchanged, and it simply permits the deduction of charitable contributions. Section 170(b), which establishes limits on the deduction, is substantially revised to permit a taxpayer to deduct all of his gifts of appreciated long-term capital assets (held for 12 months or more) up to 30% of his "contribution base." Thus, it is obviously necessary to compute the taxpayer's "contribution base" before it is possible to determine how much of his gift of appreciated property is in the words of the new Section 84 within the Section 170 deduction ceiling and hence an "item of tax preference."

"Contribution base" is defined as "adjusted gross income" increased by the "allowable tax preferences" as determined under Section 277(c)(2). Under Section 277(c)(2), "allowable tax preferences" are the total of all "items of tax preference" determined under Section 84(c) not included in the taxpayer's gross income (i.e. not disallowed), provided they exceed $10,000.

So here we are. In order to determine his "limit on tax preferences" (LTP), the taxpayer must first know the total of his "items of tax preference." In the case of a gift of appreciated property to charity, he cannot determine this until he knows how much of that gift is deductible under the Section 170 ceiling. To ascertain this deductible amount, however, he must first compute his "contribution base." But he cannot compute the "base" until he knows what part of the donated appreciation is within his LTP and hence an "allowable tax preference." The circle is complete. Neither the Bill nor the Committee Report gives us any clue to avoiding this circle.

An explanation for this circularity can perhaps best be found in the concepts that seem to have guided the thinking of the House Ways and Means Committee on the matter of "tax preferences" and in the Committee's failure to distinguish between gifts of appreciated property and the other four "preferential" items. This discussion will also explain why the policy objective sought by the Bill cannot be achieved by simple arithmetic calculations of the type traditionally used in the Tax Law. Rather, a complex of three and perhaps four simultaneous algebraic calculations are required.

The Committee Report is cognizant of the close inter-relationship that exists between the limit on tax preferences and the allocation of deductions. It states:

"Under the bill, individual taxpayers may be subject to the limit on tax preferences, as well as being required to allocate their deductions. The bill provides in effect that (1) such a taxpayer is to first apply the limit on tax preferences (that is, to add back to taxable income that part of non-taxable income in excess of 50 per cent of total income), and (2) he then is to allocate deductions between adjusted gross income as modified in step (1) and the allowed tax preference items." (Committee Report, p. 83.)

This statement is revealing for it establishes that in the Committee's mind, all five of the "items of tax preference" are tantamount to items of "non-taxable income," even though this is only strictly true of the tax exempt bond income and the one-half of long term capital gains that is deducted (excluded) in the computation from gross to adjusted gross income. The Committee explains:

"Under present law, there is no limit on how large a part of his income an individual may exclude from tax as a result of the receipt of various kinds of tax exempt income. Individuals whose income is secured mainly from tax-exempt State and local bond interest, for example, may exclude practically all their income from tax. Similarly, individuals may pay tax on only a fraction of their economic income, if such income is derived primarily from long-term capital gains (only one-half of which are included in income) or if they enjoy the benefits of accelerated depreciation on real estate. Individuals may also escape tax on a large part of their economic income if they can take advantage of the present special farm accounting rules or can deduct charitable contributions which include appreciation in value which has not been subject to tax."

In the terms of reference used by the Committee, there is a certain similarity between gifts of appreciated property and the other items of "tax preference," in that they all directly or through deductions may give rise to what the Committee characterizes as "tax exempt income." But the difference is much more fundamental. All of the other "items of tax preference," except gifts of appreciated property, arise out of transactions by which "economic income" flows to the taxpayer. In the case of tax exempt bond income and the capital gains deduction, the economic income is simply not taxed. In other cases, such as excess farm losses and accelerated depreciation, the economic income is partially or wholly off-set by deductions which bear no reasonable relationship to the costs of producing that income.

Thus, by treating these other items as "preferential," the Bill is designed to capture for tax purposes some part of this otherwise tax-exempt economic benefit, either directly or through adjusting the deduction to more nearly reflect the actual costs of producing the associated income. And in all cases the "preferential" amount is susceptible of measurement by an independent standard. In the case of

exempt bond income and the excluded capital gains, the total amount of exempt economic benefit is the measure of the preference; in the case of accelerated depreciation and excess farm losses, the "preference" is the difference between the depreciation or farm expense deduction actually claimed and the more accurate measure of straight-line depreciation or the current costs of farming.

None of this holds true for gifts of appreciated property. In making the gift the taxpayer has not produced any economic income. He has given away irrevocably the economic benefit in the donated property without any economic return. There is no "tax-exempt" income associated with the gift which LTP can capture.

Because of this fact, there is no other measure of the amount of "preference" except the amount of the deduction to which the taxpayer is actually entitled by reason of the gift. In the case of the other "preferential deductions" the fact that the transactions in question give rise to economic income means that the preference can be measured by reference to an independently determined standard representing the reasonable costs of producing that income. In the case of appreciated property, there is no economic income, so that the only standard available for measuring the taxpayer's preference is the amount he could otherwise actually deduct were LTP not in the picture.*

It is this fundamental fact that produces the circularity in the Bill.

For in addition to taxing some part of a payer's exempt income through LTP, the Bill also seeks to require taxpayers to allocate some part of their deductions against the exempt income not reached by LTP (i.e. throw that deduction away). However, in the case of gifts of appreciated property it is the deduction alone that determines how much exempt income is in the picture, yet because of allocation the amount of the deduction cannot be determined without knowing the amount of exempt income. In short, the Bill has produced a tax-scheme containing two wholly interdependent variables.

Quite clearly it is the recognition of this circularity of calculations that led to the stipulation in this Bill that a donor of appreciated property is to determine his LTP without going through the step of allocating his deductions (Section 84(c)(1)(A)). But as already stated

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*Parenthetically, it might be noted that because a gift of appreciated property represents in its entirety an economic loss to the donor-taxpayer, the deduction for that gift reflects a government decision to partially compensate him for his loss. This is quite unlike the exemption and deductions associated with the other preferences which are measures to increase the taxpayer's economic gain from certain types of transactions. This governmental compensation for loss could be provided directly -- by paying the taxpayer -- or indirectly through the tax laws (i.e. shifting some part of the economic loss from the taxpayer to the government in the form of a revenue loss). But if the government chooses the deduction mechanism, it must of necessity permit the donor-

(footnote continued)

this means that he is forced to treat as preferential all of the donated appreciation up to the percentage ceiling on deductions, regardless of how much of an actual preference he has as measured by the actual amount he can deduct. Quite clearly this expedient can produce some serious distortions.**

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taxpayer to take his deduction entirely against income unrelated to the gift transaction. To not allow this is simply another way of saying that the taxpayer should bear the whole cost of the gift. And to apply LTP to gifts of appreciated property is simply a device for reducing the compensation the government is prepared to give the taxpayer as an incentive to making the gift. Now obviously, the government could achieve its cost reduction purpose directly by simply reducing the amount that may be deducted in respect of gifts of appreciated property. But it has already done this by the special 30% ceiling. It apparently wants a second crack through LTP, a most anomalous position when the Committee justifies its own proposal to increase the deduction ceiling in order:

> " . . . to strengthen the incentive effect of the charitable contributions deduction for taxpayers generally."

Apparently taxpayers who give appreciated property do not qualify as "taxpayers generally" although they may provide a very substantial portion, if not the predominate portion, of the private support of some of the most important of the Nation's charitable enterprises.

**This can be demonstrated by the example of two donors, each with income of $50,000 who make identical gifts of $100,000 of zero basis property. Assuming next that the income of one donor is divided $30,000 in the form of tax exempt bond income and $20,000 in the form of salary, while in the income of the second donor is entirely in the form of salary. Now, of course, because of the circularity of the "contribution base" calculation, it is not possible to make an exact computation for these two taxpayers. However, in order to understate the distortion we will assume that the second donor, with $50,000 of salary income, has the higher contribution base and hence, the larger charitable deduction as well as a larger tax preference because of his gift. Actually the first donor has a maximum deduction of $40,000 (30% of $120,000) and the second donor a maximum deduction of $45,000 (30% of $150,000). After computing LTP and ascertaining the allowable preferences, it will be found that the donor 3/5 of whose income in the form of tax exempt interest ends up with a taxable income of only $3,620 less than the donor whose income is 100% in the form of salary. While part of the explanation for this extraordinary result lies in the fact that the first donor has a lower maximum deduction than the second, the bulk of the discrepancy can be attributed to the fact that while the adjusted gross income of the donor with tax-exempt income is being increased through LTP by more than 200%, allocation has reduced his deduction to less than 45% of his modified adjusted gross income. While in the case of the donor with all of his income in the form of salary, his deduction is about 45% of his adjusted gross income even after allocation.

However, even if the Bill's by-passing of the allocation requirement is retained, there is a further circularity in the calculations which continues to make the Bill unworkable. It is still necessary under the Committee Bill to determine the donor-taxpayer's percentage limitation on charitable deductions. Calculation of this maximum deduction would be quite straightforward were the percentage simply applied against adjusted gross income as under current law. But -- for obviously correct reasons -- the Bill applies the percentage against a new expanded base, called the "contribution base," which is the total of adjusted gross income and "allowable tax preferences." Hence, another circle. Before you can compute the "Limit on Tax Preferences" you must at least know the maximum deduction even if you do not know the actual deduction after allocation. But the maximum deduction depends upon the "contribution base," and this latter is dependent upon knowing how much of the appreciation is within the "Limit on Tax Preference." The Bill provides no avenue of escape from this circularity of calculations.***

In sum, as applied to gifts of appreciated property, the three interrelated provisions of the Committee Bill -- the Limit on Tax Preferences, the percentage limitations on charitable deductions and the allocation of deductions -- suffer from two basic defects:

***It is not possible, for example, to avoid the problem by computing the maximum deduction as a percentage of adjusted gross income -- as under current law. For, as the Treasury recognized when it first suggested these ideas to the Committee, the moment the allocation of deductions principle was introduced it became necessary to expand the base for this percentage calculation to include any exempt income against which part of the deduction was to be allocated. In the Treasury's words, this measure was necessary:

> "In order to prevent the distortion which would result from measuring the percentage limitation for the maximum charitable contribution deduction by reference to adjusted gross income while at the same time disallowing part of that deduction on the basis of excluded items which are not part of adjusted gross income."

The Treasury's point can be illustrated by the case of a donor with AGI of $10,000 and exempt income of $10,000 who makes a $10,000 gift of zero basis stock. If the deduction ceiling were computed as a per cent of AGI alone, he would have a maximum deduction of $3,000 to be allocated 50/50 against AGI and exempt income, so that his actual deduction would be $1,500 or 15% of his income subject to tax. Another donor with $20,000 of AGI and no exempt income who makes the same gift would have both a maximum deduction and an actual deduction of $6,000 or 30% of his income subject to tax. By including the exempt income in the base for computing the first donor's percentage ceiling, the first donor becomes entitled to a maximum deduction of $6,000 (30% of $20,000) which after allocation results in an actual deduction of $3,000 or 30% of his income subject to tax.

(i) The calculation of LTP without going through the allocation procedure can produce serious distortion in measuring the extent of preference associated with a gift of appreciated property; and

(ii) The calculations called for by the Bill -- even permitting the distortion in (i) to stand -- are unworkable by ordinary arithmetical means.

Point (ii) is best illustrated by taking the simple case of a donor with salary income of $30,000, tax-exempt interest income of $20,000 who gives $100,000 of long-term capital assets to charity in which his cost basis is $10,000. As can be seen in Appendix A, it is totally impossible to follow the language of the Bill step-by-step and determine his "contribution base" or his LTP.

Now, of course, there is at least theoretically a way out of this dilemma. It is to recognize that in principle a gift of appreciation is to charity "preferential in nature" only to the extent it gives rise to a charitable deduction against other income and that, under allocation, the deduction cannot be ascertained without knowing how much of the gift is "preferential." Or, in other words, the solution, if any, lies in recognizing that the combination of LTP and the allocation of deductions pose a problem in the simultaneous resolution of three, and perhaps four, unknowns which are completely interdependent; a calculation carried out, if at all, by the use of some highly complex algebraic equations.

APPENDIX A

Assume donor has: salary income of: $ 30,000

tax exempt
interest income: $ 20,000

makes gift of
approximately: $100,000 ($10,000 over)

(1) Determination of the Items of Tax Preference (Sec. 84(c) (1) (A) & (C)):

Gift of Appreciated Property

Step 1 -- Section 84(c) (1) (A) defines as an "item of tax preference":

"The amount of the deduction (determined without regard to section 277) for charitable contributions under Section 170 . . . allowable for the taxable year which is attributable to appreciation in the value of property not included in gross income (determined without regard to this section).

Step 2 -- Next Step is Obviously to Look at Section 170.

Section 170(a)(1) states:
"There shall be allowed as a deduction any charitable contribution (as defined in subsection (c) payment of which is made within the taxable year . . .

(We assume that in this example the donor's gift is a charitable contribution under subsection (c)).

Section 170(b)(1)(A) states:

"In the case of an individual, the deduction provided in subsection (a) shall be limited as provided in succeeding sub-paragraphs of this paragraph.

Sub-paragraph B establishes a limit of 30% of "the taxpayer's contribution base" for contributions to six different categories of charitable institutions.

Sub-paragraph C establishes a general limit of 20% of the "taxpayer's contribution base" and provides that the 30% limit in sub-paragraph B is on top of the 20% limit in sub-paragraph C for a potential total of 50%.

Sub-paragraph J states:

"(i) In the case of appreciated property to which subsection (e) does not apply /subsection (e) is not applicable in our example/, the total deductions for contributions of such property under subsection (a) for any taxable year shall not exceed 30 per cent of the taxpayer's contribution base."

"(ii) /Contains special rules for carryover of deductions in excess of 30%./

Step 3 -- Next step is obviously to determine 30% of the "taxpayer's contribution base"

Section 170(b)(6) states:

"Contribution base defined - For purposes of this section, the term 'contribution base' means adjusted gross income . . . increased by the allowable tax preferences as determined under section 277(c)(2)."

Thus, ignoring the effect of LTP on adjusted gross income (see last parenthetical phrase under section 84(c)(1)(A) above), the taxpayer in our example has a "contribution base" of $30,000 + allowable tax preferences.

Step 4 -- Next step is obviously to determine the taxpayer's "allowable tax preferences"

Section 277( )(2) defines "Allowable Tax Preferences":

"(A) General Rule - The term 'allowable tax preferences' means the excess (if any) of the total items of tax preference determined under section 84(c) (but only to the extent that such items are not included in gross income under section 84) as modified in paragraphs (B), (C) and (D), over $10,000 ($5,000 in the case of a married person filing a separate return).

Since we are still trying to calculate LTP, no part of the appreciation given to charity has been included in gross income under section 84, neither are subparagraphs (B), (C) & (D) applicable, hence we must return to section 84(c) to ascertain the amount by which the "items of tax preference" exceed $10,000, but if we return to section 84(c), we are referred to §170(b)(1)(J), under which we must know the contribution base. This, in turn, refers us to section 170(b)(6), where we are referred back to section 277(c)(2)(A), and the circle continues.

SUMMARY OF STATEMENT

BY

HERMAN L. TRAUTMAN
PROFESSOR OF LAW
VANDERBILT UNIVERSITY

SUBJECT: CHARITABLE REMAINDER TRUSTS UNDER H.R. 13270

PRINCIPAL POINTS

1. The effective dates provided in Section 201 (j) for the income tax, gift tax, and estate tax provisions of H.R. 13270 concerning charitable remainder trusts should not be approved.

   a. No reference is found in the pamphlet entitled "Tax Reform Proposals Contained in The Message from The President of April 21, 1969" published by the Treasury on April 22, 1969.

   b. Many irrevocable gifts to colleges and universities were completed between April 22, 1969 and the introduction of H.R. 13270 without an adequate opportunity to comply with its provisions.

2. The deduction for charitable remainder trusts should not be restricted to the two forms stated in H.R. 13270 - the dollar annuity and the unitrust.

   a. The life income - remainder trust, without allowances for contingent interests or invasion of corpus is better calculated to accomplish the tax policy values stated in House Report No. 91-413 (Part 1) p. 58 than either the dollar annuity or the unitrust.

   b. The "general reasons for change" stated in the House Report postulate a breach of trust, which is not typical, and for which there is an adequate remedy in the state courts.

   c. The Treasury studies prepared by the Johnson Administration originated the proposals on the ground that abuse situations might be available, but cautioned that "it is impossible accurately to calculate the extent of their use."

   d. Neither the dollar annuity nor the unitrust "necessarily have any relation to the value of the benefit the charity receives"

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e. The American people understand the life income-remainder concepts, and when properly protected against contingencies and invasion of corpus provisions, the arrangement is far superior to the dollar annuity and the unitrust.

f. The unitrust has complexities which far outweigh any problems of the life income-remainder trust.

g. It would be well to tighten the rules as to life income-remainder trusts to disallow deductions for contingent interests to charity and gifts subject to a power of invasion.

3. Gifts of appreciated property to a charitable remainder trust should not result in a realization of gross income to the donor.

a. It has been a traditional doctrine in our tax law that a gift is not a realization of income. If this is changed with respect to gifts to charities of future interests, it can be changed to apply to gifts between members of a family.

b. To compel the donor of a charitable remainder interest to elect between limiting the income tax deduction to his basis or include the difference between his basis and fair market value in gross income is harsh tax treatment, and it will result in the elimination of a very desirable type of gift to charities.

c. The harsh tax treatment postulated for gifts of charitable remainder interests is not justified by the facts of human experience. This type of giving represents a major source of income to private educational institutions and colleges.

d. The current tax consequences concerning gifts of appreciated property to charity represents a conscious tax policy decision of the Congress of the United States in 1938. It is not a tax loophole.

STATEMENT

OF

DR. HERMAN L. TRAUTMAN
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VANDERBILT UNIVERSITY

SUBJECT: CHARITABLE REMAINDER TRUSTS UNDER H. R13270-
THE TAX REFORM ACT OF 1969

I INTRODUCTORY

Section 201 (c) of H. R. 13270 - The Tax Reform Act of 1969, amends section 170 of the Internal Revenue Code of 1954 by providing a new subsection (h) which provides that no income tax deduction is to be allowed under section 170 for charitable contributions of a remainder interest in trust, unless the trust is cast in the form of either (1) a specific dollar annuity trust, or (2) a unitrust. These concepts are defined in a new code setion 664 (d) proposed in 201 (i) of H. R. 13270.

Subsection (h) of section 201 of the Tax Reform Act of 1969 would amend code section 2055 to deny the estate tax charitable deduction for gifts of remainder interests to educational and other qualified charitable institutions unless the gift was cast in the form of either (1) a dollar annuity trust, or (2) a unitrust. It also would amend code section 2522 to deny the gift tax charitable deduction for any gift which did not qualify as an income tax deduction under code section 170 as amended.

Thus subsections (c), (h) and (i) of Section 201 of H. R. 13270 amend all three types of Federal taxes - the income tax, the estate tax, and the gift tax - so as to deny a charitable deduction under each tax for contributions of vested remainder

interests in all types of property, industries, farms, business buildings, stocks and bonds, unless cast in the limited forms of either a dollar annuity or a unitrust. Importantly, the typical gift of a farm, a business building, stocks or bonds to a University in trust to pay the income to the donor and his wife for life, remainder to the University in fee simple would not qualify as a charitable contribution under either of the three Federal taxes if subsections (e), (h) and (i) of Section 201 of the proposed bill are enacted into law.

Section 201 (j) provides that the above proposed amendments shall be retroactive to transfers in trust made after April 22, 1969 with respect to the income tax and the gift tax, and that the estate tax amendment shall be applied in the case of decedents who die after the date of enactment of the bill.

II THE EFFECTIVE RATES STATED FOR SUBSECTIONS 201 (e), (h) and (i) SHOULD NOT BE APPROVED

In early July, 1969 a retired couple in Middle Tennessee made a gift of their farm to Vanderbilt University in trust to pay the income to them for their lives, and the life of the survivor of them, the trust to terminate at the death of the survivor, with a gift of the legal remainder to Vanderbilt University in fee simple absolute. This gift was closed only after the most careful research in the current law concerning charitable remainder trusts, and special provisions were included to assure that the complete corpus of this trust principal would become available for the educational benefits of Vanderbilt University at the death of the survivor. Under no circumstances can there be any invasion of corpus for the benefit of the income beneficiaries, and there are no contingencies

which might possibly cause this trust estate to pass to anyone other than Vanderbilt University. This was an irrevocable trust, so that it cannot be changed to adapt to the forms provided in H. R. 13270. It is the typical charitable remainder trust, reserving a life income interest to the donors, which is used so frequently by colleges, universities, hospitals and other charities across the United States for their development programs. Because it is neither a specific dollar annuity trust nor a unitrust it will not qualify for either an income tax deduction or a gift tax deduction if the retroactive date of April 22, 1969 is approved; nor will it qualify as an estate tax deduction upon the deaths of the donors in the years ahead, because it is an irrevocable trust, and as such, the terms of the gift cannot be changed.

In my weekly reading of tax loose-leaf reports and current tax literature there was no mention made to my knowledge prior to the introduction of H. R. 13270 that charitable remainder trusts would be a subject of proposed tax reform.

Since the introduction H. R. 13270 we have examined the announcements and proposals of the President and those of the Ways and Means Committee with respect to public notice concerning charitable remainder trusts. On April 22, 1969 the Treasury published a pamphlet entitled "Tax Reform Proposals Contained in The Message from The President of April 21, 1969". We are unable to find any reference in the Treasury's tax reform proposals of April 22, 1969 which would put one on notice as to charitable remainder trusts.

3.

On May 27, July 11, and July 25, 1969 we now find that the Ways and Means Committee announced tentative dicisions on tax reform subjects. The release of May 27 makes the following statement, which is certainly not a suggestion that charitable remainder trusts would be allowed only if cast in the form of a dollar annuity trust or a unitrust:

> "(7) Split-Interests Trusts. - The Committee tentatively decided in the case of split-interest trusts (a trust under which the income is paid to provide persons and the remainder to charity, or vice versa) to adopt a provision under which the charitable contribution deduction would be recaptured in whole or in part where the investment policies of the trust - as between the income and the remainder beneficiaries - are not consistent with the assumptions on which the deduction was originally computed, and also to adopt a provision disallowing a charitable contribution deduction for a gift to charity in the form of an income interest in trust where the remainder is to go to a non-charitable beneficiary."

There was apparently no reference to the subject in either the July 11 or July 25 releases.

III. THE DEDUCTION FOR CHARITABLE REMAINDER TRUSTS SHOULD NOT BE RESTRICTED TO ONLY TWO FORMS OF THE GIFT - THE DOLLAR ANNUITY OR THE UNITRUST

Financing the private university is increasingly difficult in these days of inflation, world involvement, and social and scientific developments. The work of the great private universities and colleges of America cannot be financed by the tuition paid by their students; such schools must rely upon the gifts of donors. A popular form for such gifts is the charitable remainder trust made during the lifetime of donors, reserving to them a life income interest.

4.

Under present tax law a charitable contribution deduction is generally available for the remainder interest given to charity. This is true with respect to the income tax and the gift tax for values determined at the date of the gift. Because of the retained life estates, such gifts are also included in the gross estates of the donors upon their deaths, but the values included are not those at the date of the interviews gift, but rather those at the deaths of the donor. A charitable deduction is also allowable under the estate tax, however, for the date of death value at which the trust property was included in the gross estates of the donors. The amount of the charitable deduction for income and gift tax purposes is based upon the application of actuarial tables published in the Treasury Regulations to market or appraised value of the property at the date of the gift. For estate tax purposes the full value of the property at date of death is included in the gross estate and deducted as a charitable death gift.

The policy statement concerning the limitations proposed in in H. R. 13270 for charitable remainder trusts appears on pages 58 and 59 of House Report No. 91-413 (Part I) as follows:

> "General reasons for change. -- The rules of present law for determining the amount of a charitable contribution deduction in the case of gifts of remainder interests in trust do not necessarily have any relation to the value of the benefit which the charity receives. This is because the trust assets may be invested in a manner so as to maximize the income interest with the result that there is little relation between the interest assumptions used in calculating present values and the amount received by the charity. For example, the trust corpus can be invested in high-income, high-risk assets. This enhances the value of the income interest but decreases the value of the charity's remainder interest.

5.

Your Committee does not believe that a taxpayer should be allowed to obtain a charitable contribution deduction for a gift of a remainder interest in trust to a charity which is substantially in excess of the amount the charity may ultimately receive.

One may agree wholly that a charitable deduction should not be allowed "which is substantially in excess of the amount the charity may ultimately receive" and yet be shooked at the proposal to limit the charitable remainder gift to those which are cast in the form of a dollar annuity or a unitrust. I submit the following comments and suggestions for improving the present law and rejecting the proposals of H. R. 13270 with respect to the charitable remainder trust:

(a). There seems to be scant evidence of abuse in this area of tax law. The typical arrangement is a gift to the university as trustee to pay the income to the donors for life, with a legal remainder to the university. Thus the university is both the trustee of the trust for the lives of the donor and the owner of the legal remainder interest. Typically there are no contingent gifts to charity. Occasionally there are invasions of corpus provisions for the support of the donors. The present tax law can be adequately improved by expressly disallowing a deduction for contingent remainder gifts to charity, and also disallowing a charitable remainder trust which is subject to any power to invade the corpus of the trust for any purpose.

(b). The "general reasons for change" stated in House Report No. 91-413 (Part 1) at page 58 postulate a breach of trust by the trustee of a charitable remainder trust in the management of the funds, for which there is an adequate remedy in the state chancery courts.

6.

1. It is basic trust law that a trustee must make only those investments which a prudent man would make consistent with both the production of income and the preservation of capital.

2. The House Report states that the present law for determining the amount of the charitable deduction in the case of gifts of remainder interests "do not necessarily have any relation to the value of the benefit which charity receives" because "the trust assets may be invested in a manner so as to maximize the income interest with the result that there is little relation between the interest assumptions used in calculating present values and the amount received by charity" See pg. 58. This is contrary to the prudent man rule, stated above, which is basic to the law of trusts. It is also highly unlikely in the typical case where the university serves as trustee and is also the owner of the remainder interest. There is little evidence, if any, that universities and other charities are allowing their remainder gifts to be squandered by investments in high income, high risk assets to the detriment of the interest which finally passes to charity. If the donor serves as trustee, or, if there is an independent trustee, the charity as owner of the remainder has a remedy in the chancery courts which it can be expected to manage responsibly.

3. The Treasury Department, Tax Reform Studies And Proposals, issued February 5, 1969, prepared by the Johnson Administration without recommendation before it left office, in effect admits that the postulate upon which Section 201 (e) (h) and (i) of H. R. 13270 and House Report 91-413 (Part 1) at 58 is based is not supported by actual evidence; that instead it represents what is imagined to be a "generally available abuse situation", i.e., that "the trust corpus can be invested in high-income, high-risk assets" which "enhances the value of the income interest but decreases the value of the charity's remainder interest" See House Report, p. 158. The Treasury Department, Tax Reform Studies and Proposals at p. 185 state the following:

> "The changes recommended involve generally available abuse situations and it is impossible accurately to calculate the extent of their use. It is unlikely that the correction of these abuses will have a significant revenue effect."

4. To the extent that there is any basis in fact for the indulgence of a breach of trust law as postulated by the House Report, the present tax law can be adequately

7.

amended to provide for the recapture of the Charitable deduction from the donor and for a penalty to the charity which condones a breach of trust by allowing the dissifration of its remainder gift.

(c). Neither the fixed dollar annuity trust nor the unitrust proposed in H. R. 13270 "necessarily have any relation to the value of the benefit which the charity receives" Both schemes assume a rate of discount for determining the value of the charitable remainder gift which is arbitrarily selected, and not likely to be consistent with economic reality. Indeed, the rate assumption made may be more than the income actually received, so that the charity would receive less than the deduction allowed.

(d). The American people understand the life income-remainder concepts much better than they do the unitrust and the dollar annuity. Our courts understand the life income-remainder concepts, too, and they have done a good job in protecting the respective interests.

(1) The proposal in H. R. 13270 discriminate against the gift of a farm, business building, or other non-liquid asset where the distinction between the income-interest and remainder interest is simple and will be understood.

(e). The unitrust has its own complexities which far out-weigh anything in the traditional life income-remainder trusts. Among these are the following:

1. Annual appraisals must necessarily be made to determine the distributions for the next year to the beneficiary. These are expensive.

2. How could you distribute 6% of a farm each year? The unitrust required liquid assets such as stocks and bonds. In effect the H. R. 13270 would forbid charitable remainder gifts in anything other than liquid assets.

8.

3. An idependent trustee must be the sole party responsible for making the annual determination of value in the case of trusts having real estate or closely held stock. This is very expensive. How is this a help to our people?

(f). It may well be desirable to tighten up the present rules to deny a charitable deduction for contingent interests, and trusts subject to invasion of any kind. There could also be penalties against both the donor and the charity for condoning a breach of trust. It does not follow that the deduction for all charitable remainder trusts should be denied except those cast in the form of a fixed dollar annuity or the unitrust.

(g). The proposals in H. R. 13270, Section 201 (e), (h) and (i) represent a clear case of "overkill". The economic interest which the charity will receive from a gift of a vested remainder interest which is prudently managed under the law of trusts, when there is no possibility of invading corpus, is much more readily ascertainable than can possibly be true under either the fixed dollar annuity or the unitrust. This is true because of the international pressure on the dollar as a currency and our world involvements.

IV. THE TAX POLICY OF THE UNITED STATES SHOULD CONTINUE TO REJECT THE IDEA THAT GIFT TO CHARITY IS A REALIZATION OF GAIN

A gift of a charitable remainder interest is a gift of a future interest to charity. Such gifts usually consist of property which has appreciated in value in the hands of the donor. Section 201 (c) of H. R. 13270 proposes to amend Code section 170 (e) to provide that in the case of gifts of a future interest in appreciated property the donor must elect to treat

either his adjusted basis in the property or the fair market value of the property as the amount of his contribution. In the latter event he must treat the contribution as if it has been a sale, and recognize any gain which he would have realized if he had sold the property at the time of the contribution for its fair market value. This will drastically curtail the charitable remainder trust as a form of life-time giving, much to the financial detriment of the colleges and universities of America.

A taxpayer who contributes property which has appreciated in value to charity generally is allowed a charitable contributions deductions for the fair market value of the time of contributing and because a gift has traditionally not been regarded as a realization of income, the appreciation in value has not been included in the gross income of the donor. The combined effect of not taxing the appreciation in value and at the same time allowing a charitable contributions deduction for the fair market value of the property produces a tax benefit which is greater than that in the case of contributions of cash gifts. This is true because of our traditional principle that a gift is not a realization of income, a principle which is much broader in its significance than gifts to charity. If the Senate approves the House proposal in Section 201 (e) that a gift of appreciated property is a realization of income, the next tax bill to come before you will surely propose that a gift of appreciated property to your wife and your children will be both a taxable gift subject to the gift tax and a realization

of income subject to the income tax. Likewise, upon this hypothesis, the death of an owner of appreciated property will result in both a death tax and an income tax. The American people will have the good sense to reject this idea emphatically, when they understand it, and it is unnecessarv to correct the problem of the stepped-up basis provision of Code section 1014.

The tax benefit involved in the gift of appreciated property to charity is ordinarily the capital gains tax that would result if the property had been first sold for cash and the proceeds given to charity. The great majority of gifts to colleges and universities consist of property which would have resulted in a capital gains tax if it had been sold prior to the gift. It would be possible to make a distinction between gifts of capital gain property and gifts of ordinary income property if that is considered necessary.

While the gift of appreciated property is often referred to as a double-blessing rule, this is not a "tax loop-hole" that should be corrected by the 91st Congress. Instead, it represents a conscious tax policy decision of the Congress of the United States in 1938. In that year a subcommittee recommended a change to limit the charitable deduction to the cost of the donated property, and this was adopted by the House. (See H. R. Rep. No. 1860, 75th Cong., 3d Sess. 20 (1938). But the change was rejected by the Senate Finance Committee, and it was not enacted. (See S. Rep. No. 1567, 75th Cong., 3d Sess. 14 (1938); H. R. Rep. No 2330 (Conference), 75th Cong.,

11.

3d Sess. 35 (1938). Trautman, Taxation Of Gifts In Trust To Charitites Reserving A Life Income Interest, 14 Vanderbilt Law Review 597, 598-99, footnotes 11-13 (1961). Thus, the decision that a gift shall not be considered to be realization of income, and that a gift to charity shall not be considered to be a realization of income even though the donor receives the tax benefit of a deduction for the full market value represents a conscious tax policy decision by the Congress of the United States which defines the scope of the policy to encourage gifts to established colleges, universities, and other recognized charities. It is not an unintended or inadvertent tax loop-hole.

The Congress having consciously established the existing tax policy in 1938, it is understandable that gifts of appreciated property have become a major source of development funds to private educational institutions since that date. If it were completely eliminated, Federal funds would be needed to support these colleges, raising constitutional questions regarding the use of Federal funds because of the traditional separation of Church and State.

To distinguish between gifts of present interests in property and gifts of vested future interests is purely arbitrary and unreal, and it will severely restrict the development efforts of colleges and universities will respect to the solicitation of any gifts from donors. The gift of a charitable remainder trust is an attractive leader for the college development office because it assures the donor of his life-income interest.

The Congress ought not at this time attempt to deal with the delicate and far-reaching implications of changing a tax

12.

policy decision which it made consciously in 1938 concerning gifts of appreciated property to operating charitable institutions. The impact of a hurried and unwise decision upon some of the greatest charitable institutions in America is much too important to act upon in an effort to correct tax loop-holes and untimely tax benefits such as the investment credit, excessive depreciation allowances, rules concerning the unrelated business income and other activities of private foundation, etc. If there is a desire to change the tax policy decision of the Congress in 1938 concerning gifts of appreciated property, it ought to be considered and debated thoroughly, and the public should be given an adequate opportunity to consider it and participate in the tax policy decision.

Statement of Dr. T. W. Van Arsdale, Jr., President, Federation of Independent Colleges and Universities of Illinois

1. It is our contention that gifts to colleges and universities should be excluded from "tax preference income" and "allocations for deductions." In this Nation, about thirteen billion dollars are given annually to colleges and universities, churches and charities. Analysis of gifts to colleges and universities, whether independent or tax-supported, in our State, indicate that annual support from gifts of such nature range from 5 percent to 20 percent of the annual operating budgets of those institutions. Apprehension of passage of the Senate of H.R. 13270 has already reduced demonstrably such annual support. Without which, such institutions, already hard-pressed for funds, conceivably could face extinction or, perhaps even worse, diminishing quality of education. Candidly, if this bill is enacted, private giving would indeed be drastically curtailed, with the inevitable result of the Federal Government's necessary replacement of honest philanthropy with additional tax dollars. How else can the public-private diversity in higher education, which I truly believe all of us endorse, prevail?

2. We applaud and endorse the objective of H.R. 13270 to eliminate "tax loopholes" of certain foundations. Clearly, there are abuses exercised but certain foundations,--but these are few in number--both financially and philosophically, which should be eliminated because they are inherently conceived as "tax dodges," nonetheless, as H.R. 13270 is presently written, correction of or elimination of such "loopholes" are realistically unenforceable, will involve remarkably increased bureautic investigate expenditures. Further, the restrictions which the bill proposes to impose upon foundations will inevitably result in curtailment of research, innovative programs and major capital gifts for facilities which are desperately needed by colleges and universities.

3. The implications for the future which result from passage of the bill are indeed frightening and inimcal to contemplate. While the aims of H.R. 13270 are stated as "tax-reform", the implementation of them could well mean bureaucratic manipulation of the educational direction and destinies of our youth through denial of adequate voluntary financial support to our institutions of higher education, whether public or independent. But in another milieu, passage of this legislation could well mean that we have "big brother": or, if the bill is thoughtfully and realistically rewritten, we can retain and sustain the freedoms indigenous to higher education which have, historically, given these institutions the opportunities to seek and receive funds which provide for innovation, relevant social responsibilities and increasing quality in their educational programs.

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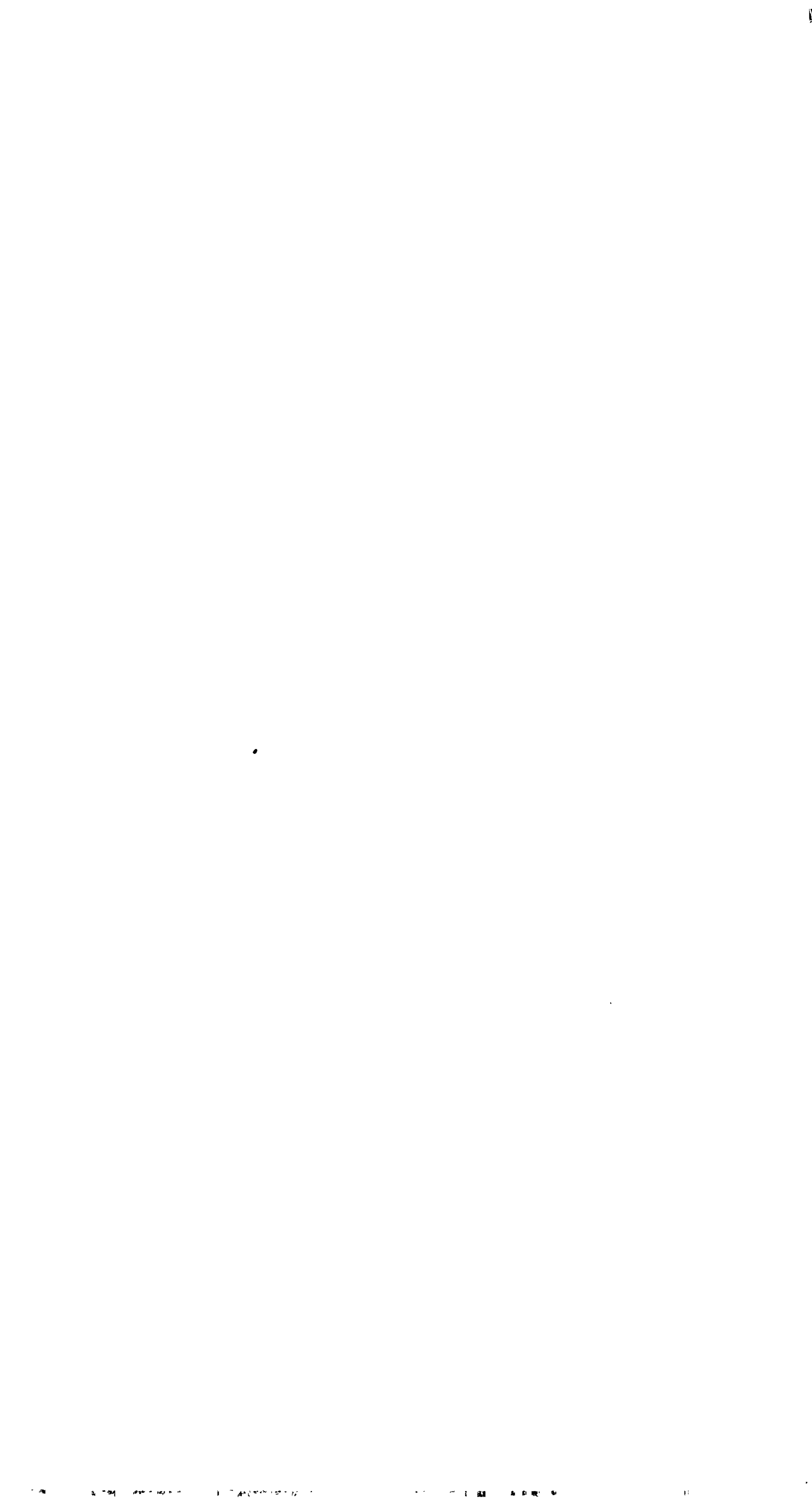


September 18, 1969

SUMMARY TESTIMONY ON H. R. 13270

SUBMITTED ON BEHALF OF TULANE UNIVERSITY
BY
DR. CLARENCE SCHEPS
EXECUTIVE VICE PRESIDENT

Our testimony is limited to those provisions of the House Bill which we believe will be directly and seriously harmful to the welfare of Tulane University.

The provisions which concern us are as follows:

I.

(a) The inclusion of the appreciated value of real property and securities contributed to charity within the definition of tax preferences. (Sec. 301(a), p. 165)

(b) The inclusion of the appreciated value of property contributed to charity in the itemized deductions to be allocated between taxable and nontaxable income. (Section 302, p. 173)

The foregoing provisions would result in serious detriment to the giving program of Tulane University because:

(a) The donor would lose a large part of his incentive for making a gift.

(b) The larger the gift, the less in percentage terms can be taken as a deduction.

(c) The more tax preferences a donor has, the more costly his gift would be.

(d) The complicated provisions in the House Bill would lead to an uncertainty on the part of the donor as to what effect the gift would have on the donor's tax picture. Such complicated provisions run completely contrary to two avowed principles of tax reform - that is, simplification and clarification.

A substantial percentage of the donations made to Tulane University by individuals consists of property and securities which have substantially appreciated in value in the hands of the donors. Of the total of approximately $5,000,000 in gifts that individuals made to Tulane between 1966 and 1969, more than $1,000,000 was in the form of securities, the vast majority of which were given on the basis of appreciated value.

II.

The elimination of a charitable deduction for the type of charitable remainder trust currently in use, and the deduction for the gift of an income interest.

In the past two years, Tulane like many other institutions of higher learning has worked out several plans for this kind of giving, which plans have been carefully tailored to take advantage of present tax incentives. Such gifts are just beginning to result in significant increases in the endowment funds of the University. Without the tax benefits now being permitted, together with the doubts which the provisions of the House Bill cast upon the ultimate tax treatment of such plans, this phase of our program would be destroyed.

III.

The $7\frac{1}{2}\%$ tax on foundation investment income.

Foundation support has played a vital and definite role in the development of Tulane University since pre World War I days and has been a significant factor in raising the character of the institution from a small, primarily local institution to one of some importance to the region, to the Nation, and in international affairs--particularly Latin American. In the past five years foundation gifts and grants have amounted to approximately $16,000,000. If all of these grants had been reduced by the amount of the proposed $7\frac{1}{2}\%$ tax, the loss to Tulane would have been considerable.

The so-called tax reforms applicable to higher education could not have come at a more critical time in the life of American colleges and universities. Many of the private institutions of the Nation as well as a growing number of state universities are finding it difficult to maintain their quality in the face of mounting financial difficulties. In Tulane's case the problem is particularly critical, for in the past 15 years this institution has operated on a deficit basis using up its unrestricted endowment funds as we went along. Tulane has no parent body to turn to for help, nor does it have recourse to state appropriations for support. Tuition has already been increased to a point of diminishing returns. It has

been increasingly necessary for Tulane to turn to its alumni, private individuals, corporations, and foundations for support. If Tulane is to survive, it must not only maintain its present level of giving but it must increase this level by at least the factor of two.

Without the full incentives which have been in the tax laws ever since Congress first enacted an income tax statute, the level of private giving to Tulane could be reduced and this could be a threat to the continued existence of the institution.

CS/rs

September 18, 1969

Senate Finance Committee
Room 2227
New Senate Office Building
Washington, D. C.

Gentlemen:

H. R. 13270
(Submitted on behalf of Tulane University)

Tulane University is deeply concerned over the directly adverse effects which certain provisions of H. R. 13270 may have on it, and is therefore particularly grateful for this opportunity to present its views to the Committee.

We know that you have received a volume of material from experts on taxation dealing with the technical aspects of the proposed changes and, further, that you have been made aware of the very sound equitable and logical distinctions between the basic so-called "tax preferences" and the preferences associated with property donated to charity. Therefore, we will try to confine our discussions to those provisions of the House Bill which we believe will be directly harmful to the welfare of Tulane University, and, in fact, to all institutions of higher learning in this country.

When the House rejected the direct tax upon the appreciated value of donated securities and real estate it was hoped that this meant that it did not desire to discourage charitable giving, but it now appears that two other provisions of the Bill make this hope illusory. The provisions to which we refer, and the others of chief concern to us are listed as follows:

1. (a) The inclusion of the appreciated value of real property and securities contributed to charity within the definition of tax preferences; (Sec. 301(a), p. 165)

   (b) The inclusion of the appreciated value of property contributed to charity in the itemized deductions to be allocated between taxable and nontaxable income; (Sec. 302, p. 173)

2. The elimination of charitable deduction for the type of charitable remainder trust currently in use, and the deduction for the gift of an income interest; and

3. The 7½% tax on foundation investment income.

If the provisions referred to under 1(a) and (b) above become law, a donor would lose a large part of his incentive for making a gift. Under these provisions, the larger the gift, the less in percentage terms can be taken as a deduction. Additionally, the more tax preferences a person has, the more costly his gift would be. Another serious problem is the uncertainty which is created by these complicated provisions. Neither the fund raiser nor

the prospective donor would be able to tell what effect the gift would have on the donor's tax picture until the tax year was over. This aspect would itself be a major deterrent to any substantial capital fund-raising effort. The addition of such complicated provisions runs completely contrary to two avowed purposes of tax reform - that is, simplication and clarification.

While it may be argued that the motives of prospective donors should be love of their Alma Mater and interest in promoting the cause of higher education, as a practical matter we know that the favored tax treatment of such gifts has been a major factor in motivating this type of giving.

The taxpayer holding appreciated property may avoid any tax consequences simply by retaining the appreciated property, and there is certainly nothing inequitable or morally wrong in giving such a person a tax incentive to convert his gain to the public benefit by means of a charitable gift. It is our belief that the repeal of the unlimited charitable deduction is a sufficient safeguard from abuse of the privilege granted to charitable givers.

A survey by the American Council on Education indicates that a large percentage of the donations presently being made to institutions of higher learning consist of property or securities which have substantially appreciated in the hands of the donors. Of the total of approximately $5,000,000 in gifts from individuals to Tulane between 1966 and 1969, approximately $1,000,000 was in the form of securities, the vast majority of which were given on the basis of appreciated value.

Those provisions listed under number 2 above (Sec. 201(i) would substantially change the present tax treatment of charitable remainder gifts and virtually eliminate the deduction for the gift of an income interest in property. In the past few years Tulane has worked out several plans for this sort of giving which have been carefully tailored to take advantage of the present tax incentives. Such gifts are just beginning to place substantial sums into the endowment of the University. Without the immediate tax benefits now permitted, and the doubt which the provisions of the House Bill cast upon the ultimate tax treatment of such plans, we feel that this phase of our program would literally be destroyed.

The third provision of the House Bill to which we are vigorously opposed is the 7½% tax on foundation investment income. A large portion of this income goes to higher education and such a tax would substantially reduce the funds available for this purpose.

Foundation support has played a vital role in the development of Tulane University since pre World War I days, and has been a significant factor in shaping the general character of the institution. The matching grants made by the General Education Board in 1946 and 1951, totaling nearly $3,000,000, on condition that the University match those sums, stimulated our early successful fund-raising campaigns, which otherwise might not have been embarked upon. The Ford Foundation endowment grants to the University and the School of Medicine in 1957, totaling $6,200,000, gave substantial impetus to the University at that time. Probably the most significant grant in the history of the school was the Ford Challenge Grant offered in 1964, under which the Ford Foundation agreed to contribute $6,000,000, if the University would raise $12,000,000 from other private sources. Stimulated by this offer, the ensuing drive raised almost $28,000,000. This enabled Tulane, among other things, to increase faculty salaries from approximately

a "D" average in the A.A.U.P. Grading Scale to a "B" average, and assisted in providing an urgently needed Library and a fine new Science Building.

These examples are but a few of many which have enabled the University to provide a high-quality educational program in the Deep South. In the past five years foundation gifts and grants have amounted to approximately $16,000,000. If all of these grants had been reduced by the amount of the proposed 7½% tax, the loss to Tulane would have been considerable.

It is indeed unfortunate that, in this time of greatest need for support, the House has chosen to advance proposals which amount to a reversal of the long-standing policy of Congress toward encouragement of higher education, particularly in the private sector. It would appear especially unfortunate if legislation were enacted which would do serious harm to higher education in the United States, in order to deal with what is apparently a very small number of individuals who may be using gifts of appreciated securities as a means of reducing their liability for taxes. It would also appear to be false economy, as Congress has recognized in the past that Government is amply compensated for any loss of revenue in this area by being relieved of the financial burden which

it would have to undertake to replace the services rendered by the private institution. With over 2,000,000 students expected to enroll in private schools this fall, the provisions of the House Bill, instead of easing the tax burden, will have the opposite effect if private charitable giving to these institutions is curtailed.

Perhaps some of you gentlemen feel that we are crying "wolf" before we are hurt, or, that, as one report stated, we are one of those private educational institutions (I know of none) which are "sacred cows grown fat on special treatment." If you have any thoughts such as these, please let me hastily assure you that nothing could be further from the truth.

These proposals come at a time which is critical in the life of Tulane University and indeed in the life of most of the major institutions of higher learning in this country. The population explosion has created a tremendous increase in the demand for higher education and this, together with the stress on quality education, has brought about great competition for properly qualified instructors, thus causing salaries to rise to unprecedented levels. These factors, when added to the rising costs in every phase of operations created by inflation, have stretched Tulane's limited resources to the breaking point.

It has been necessary, for the past fifteen years, for Tulane to operated on a deficit budget, at the expense of its already far too meager endowment fund. The decision to operation in this fashion was made with grave misgivings, but in the belief that it was absolutely necessary in order for Tulane to provide the type of quality education which would justify its existence.

Tulane, as an independent institution, has no parent body to turn to for help nor does it have any recourse to public funds for support. In order to meet its needs, tuition has been increased to such a point that further escalation might defeat the ends desired. Therefore, it has been increasingly necessary for Tulane to turn to its alumni, private individuals, corporations and foundations for support. It is essential to its survival that Tulane not only maintain its present level of giving, but that every effort be exhausted to increase this level.

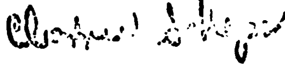
Without such assistance Tulane University could not long exist. Under such circumstances, any action which would have the effect of materially reducing the level of private giving would be catastrophic to the University.

We have good reason to believe that Tulane University plays a vital role in the life of the City of New Orleans and the State of Louisiana, and that it faces an ever-increasing challenge for greater service to the community and to the Nation. Indeed, its part in tropical medicine, primate research, Latin American affairs, and the field of competitive law, make its scope international. However, Tulane is but one of many such private institutions making a vital contribution to the life of this Nation. Like Tulane, these institutions have become dependent on private giving, not only for their advancement, but for ultimate survival.

Philanthropy to colleges and universities has produced none of the serious abuses to which tax reform is directed. We believe that the enactment into law of the provisions in the House Bill discussed above will do serious and irreparable harm to Tulane University and to private higher education in this country. This would indeed be a high price to pay for a very limited and doubtful tax gain.

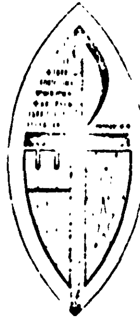
We, therefore, respectfully urge you to cure the harmful consequences which might result from the enactment into law of the provisions discussed above by excepting gifts to colleges and institutions from the operation of these provisions.

Respectfully submitted
on behalf of Tulane University,



Clarence Scheps
Executive Vice President

LUTHERAN COUNCIL



in the United States of America
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New York 10010 / Area 212-677-3950
Office of GENERAL SECRETARY

STATEMENT REGARDING PROPOSALS TO REFORM THE INCOME TAX LAWS BY MEANS OF THE TAX REFORM ACT OF 1969

Presented to: The Committee on Finance
United States Senate

The Honorable Russell B. Long, Chairman

Submitted by: Lutheran Council in the United States of America at the request of its participating church bodies: The American Lutheran Church, the Lutheran Church in America, The Lutheran Church-Missouri Synod and the Synod of Evangelical Lutheran Churches.

Summary of principal points appears first.

Oral Testimony by: Dr. C. Thomas Spitz, Jr., General Secretary, Lutheran Council in the U.S.A.

Dated: September 15, 1969

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SUMMARY OF PRINCIPAL POINTS

The church bodies participating in the Lutheran Council in the U.S.A. are concerned about both the philosophical and practical aspects of the Tax Reform Act of 1969. Since other witnesses will be testifying extensively on the practical dimensions of the proposed legislation, our testimony will focus largely on the philosophical issues.

1. VOLUNTARY ASSOCIATIONS ARE BASIC TO DEMOCRACY

Democracy depends upon the presence, the activity and the reality of free associations within society. There can be no democracy without a genuine and lively pluralism. It was not by chance that your legislative predecessors established the concept of tax exemption for contributions to charitable, educational and religious organizations. This concept grew out of the basic principals which underlie our entire government and the whole of our society.

2. A HEALTHY DEMOCRACY DEPENDS UPON RICH PLURALISM

A healthy democracy requires a wide variety of free associations that are not creations of the state nor completely dependent upon it. Such free associations, supported by the private donations and commitments of individual citizens, are a power within democratic society. Their presence is a principal safeguard against totalitarianism. In a society where such organizations are paid for by the state and come under its control, it is too easy for the state to control every aspect of life.

3. PRIVATE INITIATIVE SHOULD BE ENCOURAGED BY TAX POLICY

The nature of man is such that he must always have a relationship to associations which center on his concerns and interests. The United States Government is confronted with the alternative of encouraging the private support of free associations or of itself supporting these associations directly, in which case they would not long remain free.

If we want a democratic society and a democratic state, every effort must be made to encourage the private initiative of citizens to maintain and strengthen the rich diversity and pluralism of free associations and organizations. This has been done and can in the future be done by giving citizens tax relief to support such organizations.

4. FREE ASSOCIATIONS ARE NECESSARY TO A VITAL DEMOCRACY

Unless free associations remain vitally alive and active within American society, it will lose the basis for its pluralism and, hence, the bedrock for its own democracy. These associations remain the training ground for the democratic process in our society. Within them people are trained in the election of representative government, in debate over issues, in the toleration of the minority by the majority, and in the acceptance of democratic process for decision making. We should not take any action to undercut or weaken such associations at the very time in which our society seeks desperately for means to enhance pluralism and to develop private centers of initiative.

5. RELIGIOUS INSTITUTIONS PROVIDE A MORAL BASIS FOR SOCIETY

The Founding Fathers of our nation valued the role of religious institutions. They wanted to make certain that citizens would have the freedom and the encouragement to support such institutions to their fullest capability.

It is still the prerogative and the responsibility of religious institutions to provide a moral base for decency and honesty within our society and the government must continue to encourage the support which interested citizens provide for such religious institutions.

6. TAX RELIEF IS NOT SUBSIDY

It is in the best self interest of the democratic society to encourage private support of free associations. If it represents any kind of subsidy, it is a subsidy to help guarantee the democratic state and a democratic society. It is a safeguard against totalitarianism.

7. THE NATURE AND STRUCTURE OF OUR SOCIETY IS AT STAKE

The philosophical question which we raise is not primarily one of dollars and cents but a question of basic principal involving the nature and structure of our society and of our government.

8. PRACTICAL CONSIDERATIONS

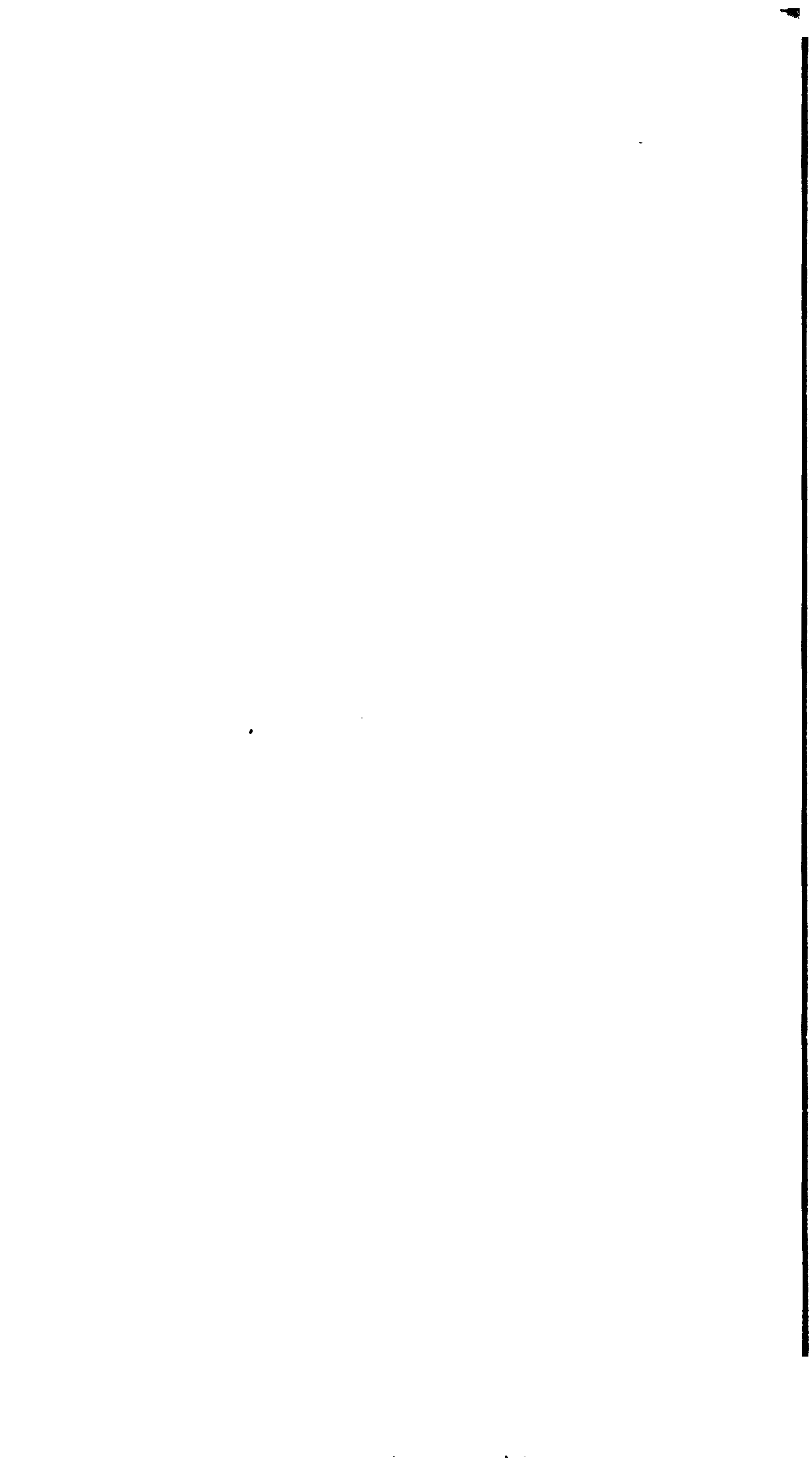
We concur with the expressions on technical aspects of the proposed legislation made to your committee by the COMMITTEE ON GIFT ANNUITIES and in the written testimony submitted by the LUTHERAN EDUCATIONAL CONFERENCE OF NORTH AMERICA.

Specifically, we affirm that gift annuities and life income agreements are in the pattern and spirit of the American way of life. These voluntary giving plans have for many years provided important support for a great number of distinguished institutions and organizations. In the past fifty years they have come into new and broader acceptance among the constituencies of our church bodies and of their institutions.

In general, giving should be pleasurable and it will not be if legislation makes it either difficult or unduly complicated to give.

Finally, persons who give to churches, colleges, hospitals, and institutions which serve human need are not motivated by profit but chiefly by generosity. Therefore charitable gifts should not be treated and lumped together with other types of tax deductions.

In summation, the Lutheran Council in the U.S.A. on behalf of its participating church bodies and their supporting relationship to more than 550 colleges, seminaries, hospitals, welfare agencies and institutions, respectfully urges that the new tax law continue the long established and essential tax incentives to charitable giving.



WRITTEN TESTIMONY TO THE SENATE FINANCE COMMITTEE
by the
Lutheran Council in the United States of America
on behalf of its participating bodies

September 18, 1969

I. About the Lutheran Council in the U.S.A.

1. Introduction

I am C. Thomas Spitz, Jr., general secretary of the Lutheran Council in the United States of America. I appear before you at the request of the Lutheran church bodies participating in the council. Those church bodies are identified in a subsequent paragraph of this testimony.

2. Appreciation

The Lutheran Council in the U.S.A. expresses appreciation on behalf of its related church bodies for the privilege and opportunity of making this presentation to the Senate Finance Committee.

The council is mindful of the problems and perplexities that must surely confront members of the Senate Finance Committee, both individually and collectively, as you seek to come to a wise decision on a difficult and complex matter. We thank and commend you for the deliberate consideration being given to all aspects of the problem with which you must deal, and for your willingness to hear the points of view of all interested parties. We trust and hope that the presentation which follows may be helpful to you in finally making right judgments about it.

3. Constituency of LCUSA

This testimony is submitted by the Lutheran Council in the U.S.A. on behalf of its participating bodies which include:

	Membership
The American Lutheran Church	2,576,027
Lutheran Church in America	3,288,037
The Lutheran Church-Missouri Synod	2,847,425
Synod of Evangelical Lutheran Churches	21,453

This council was organized in 1966 and has among its functions, as stated in its constitution:

> To represent the interest of the council, and the interests of a participating body so requesting, in matters that require common action before
>
> . . .
>
> (2) the national government. . . .

The church bodies listed above desire to register their conviction that certain aspects of proposed legislation concerning tax reforms would have a serious negative effect upon giving to and through the churches.

We have sought opportunity to testify not out of concern for the support of religion in a narrow sense, but because substantial support for welfare agencies and institutions, hospitals, colleges and universities is provided through church channels. Church bodies related to the Lutheran Council in the U.S.A. have a supporting relationship to:

47 colleges and universities
14 theological seminaries
96 hospitals
514 welfare agencies and institutions

Our participating church bodies have two aspects of concern which might be described as philosophical and practical. Knowing that others presenting testimony will focus on the practical and technical aspects of the legislation, we hope you will find it helpful if we concentrate on the philosophical consideration.

II. Philosophical Considerations

1. Voluntary Associations Are Basic to Democracy

It was not by chance that your legislative predecessors established the concept of tax exemption for contributions to charitable, educational, and religious organizations. No political pressure forced this decision. It grew out of the basic principles which underlie our entire government and the whole of our society.

Democracy depends upon the presence, the activity, and the reality of countless free associations within society. There can be no democracy without a genuine and lively pluralism. A society which exists for the sake of the state has no such pluralism. In a non-democratic state and society the state organizes, pays for, and controls all forms of association. Everything exists for the sake of the state, including the individual human being. Social organizations for children, young people, and adults, all schools and education, all health programs and activity, all churches and religious organizations are paid by the state and are dimensions of the state.

2. A Healthy Democracy Depends Upon a Rich Pluralism

A healthy democracy depends upon the rich pluralism of a wide variety of free associations that are not creations of the state nor completely dependent upon it. Organizations such as Boy Scouts, Y.M.C.A., C.Y.O., garden clubs, camera clubs, private elementary and secondary schools, colleges and universities, churches and religious organizations, fraternal organizations--all of these are free associations supported by the private donations and commitments of individual citizens. Each of them represents a quite different free center of association and power within a democratic society. It is the presence of a wide diversity of such organizations which is one of our chief safeguards against totalitarianism and the destruction of democracy. In a society where all such organizations are paid for by the state and are under control of the state, it is very easy for the state to control every aspect of life.

Without the rich diversity and pluralism of free associations, it is dubious that democracy could long exist. The question is what kind of society and government a particular state wants at a given moment in history.

3. Private Initiative Should Be Encouraged By Tax Policy

The nature of man is such that he must always have a relationship to associations which center on his concerns and interests. Human beings are always organizing into interest groups. This is true in a totalitarian society as well as in a democratic society.

The United States Government is confronted with the alternative of encouraging the private support of free associations or of itself supporting these associations directly, in which case they would not long remain free. This is not simply a question of tax dollars; it is primarily a question of the nature and dynamics of American society and of American democracy itself.

If we want a democratic society and a democratic state, every effort must be made to encourage the private initiative of citizens to maintain and strengthen the rich diversity and pluralism of free associations and organizations. This has been done and can in the future be done by giving citizens tax relief to support such organizations.

4. Free Associations Are Necessary to Vital Democracy

Unless free associations remain vitally alive and active within American society, it will lose the basis for its pluralism and, hence, the bedrock of its own democracy. It is within these free associations that children and young people are trained in the democratic process in the election of officials, debate over differing issues, the toleration of the minority by the majority, and the view that the democratic process is itself the basis of all decision-making. Free associations remain the training ground for a democratic society. Their importance lies both in the fact that they embody pluralism and in the fact that they remain the daily training ground for the democratic process in American society. The United States government should not take any action that would undercut or weaken these associations at that very moment in history when our society is searching desperately for means to enhance pluralism and private centers of initiative in our society.

5. Religious Institutions Provide a Moral Basis for Society

These organizations contribute much to American society currently and historically. The founding fathers of our nation valued the role of religious institutions very highly. While they opposed state support for religious organizations, they wanted at the same time to make certain that citizens would have the freedom and the encouragement to support such institutions to their fullest capability.

Religious institutions have traditionally provided a moral basis for decency and honesty within a society. This still remains the case. The state must not take on the primary responsibility of inculcating these

virtues. It could not do so without introducing a different set of mores or conceptions of honesty and decency in order to serve the self-interest of the state alone.

6. Tax Relief Is Not Subsidy

Tax relief for private donations to private associations is not subsidy of those organizations. It is a practical and effective way of encouraging and sustaining the pluralism that is brought to society by free, strong private associations. It is in the best self-interest of a democratic state to encourage private support of free associations. If it represents any kind of subsidy, it is a subsidy to help guarantee the democratic state and a democratic society. It is a safeguard against totalitarianism.

7. The Nature and Structure of Our Society is at Stake

We are fully in favor of constructive tax reform by the United States government. It is long overdue. However, we think this ought to be done only after a thorough study and analysis of the implications which a reduction of charitable contributions would mean to American Society today.

Above all, we respectfully suggest that you include in your consideration of tax reform legislation the implications of the destruction or the control of our free associations by the government. This question is not primarily one of dollars and cents, but a question of basic principle involving the nature and structure of our society and our government.

III. Practical Considerations

1. Concurrence With Others on Technical Considerations

Regarding specific proposals of the House-passed bill, the Lutheran Council in the U.S.A. would have your committee note that it concurs with the expressions on legislative matters made to the Committee yesterday by the COMMITTEE ON GIFT ANNUITIES in which several institutions and agencies of our church bodies participate.

It concurs also in the written testimony submitted by the LUTHERAN EDUCATIONAL CONFERENCE OF NORTH AMERICA.

2. Some Observations About Life Income Giving

As it considers revisions of presently existing tax-reducing incentives for charitable and philanthropic giving, the Senate Finance Committee will want to be mindful of these facts about the persons who make deferred or life income gifts.

a. Annuity and life income contracts have been written for a half century or more by some of the church bodies and institutions which we represent. They are in established use and are favorably regarded by them and by donors as a proper method of securing and making gifts.

b. When a person enters into a life income agreement with a religious, charitable, or educational institution, he is actually doing two things: namely, he is making a gift to the institution and is also providing income for life. If he could afford to do so, he would probably turn over the entire amount of principal to the organization as an outright gift; in many cases, however, he needs to make some provision for income during his lifetime.

c. Studies over the years have substantiated that the typical first-time contributor under one of these plans is a person in the late 60's or early 70's, more likely a woman than a man, comfortably circumstanced but by no means wealthy, quietly dedicated and committed to the cause or purpose being supported.

d. Instances of multiple gifts over a span of years from the same donor are numerous. They give persuasive evidence that life income giving arrangements do two important things for the parties involved: (a) they meet a practical need for persons in their retirement years, through the prospect of assured income for life; and (b) they afford generously inclined individuals the satisfaction of relating themselves through their gifts to a high purpose in life.

e. Some organizations accept income gifts in the minimum amount of $100. Others have $500 as their minimum amount. Gifts of this character to religious organizations typically range in amounts of from $1000 to $10,000.

f. The cumulative support derived over a period of years for a great number of noteworthy religious and charitable interests in our country through life income gifts has been impressive. It has seemed to an increasing number of church organizations that "deferred giving" may be the means of overcoming the inadequacies of current giving toward the ever mounting human needs these organizations are seeking to meet.

g. Mindful that the typical life income donor, especially under life gift, is apt to be advanced in years, and more often than not unsophisticated in financial matters, it is desirable that tax implications of these arrangements be easy to explain and simple to understand.

IV. Conclusion

In summary, the Lutheran Council in the U.S.A., on behalf of its participating church bodies and the more than 550 colleges, seminaries, hospitals and welfare institutions which they support, respectfully urges that the new tax law continue the long established and essential tax incentives to charitable giving which undergird our nation's educational, religious, hospital, health, social welfare and other charitable organizations.

SUMMARY

1. The importance of stimulating private philanthropy, which alone assures the private sector of its independence, is emphasized
2. H. R. 13270, if enacted in its present form, would be Congress' first major retreat from the time-honored principle that the voluntary benefactors of society and socially useful institutions should be recognized and rewarded in the tax laws The bill would strike a crippling blow financially to innumerable educational, health, religious, civic, and community organizations that are dependent on voluntary gift support.
3. Tax avoidance can be stopped without damage to the practice of philanthropy and to privately supported education.
4. Tax reform is imperative and the higher education enterprise applauds Congressional acknowledgment of this fact and the determination of the Congress to act constructively.
5. Concerning the charitable deduction and tax exemption provisions of H R. 13270, colleges endorse some of the concepts without reservation; they accept others; but they are strongly opposed to those which would deprive institutions dependent upon private gift support of substantial sums of money
6. Colleges in Virginia particularly oppose those provisions which:
   (a) alter the tax treatment of gifts of appreciated property where the appreciation is long-term capital gain;
   (b) classify the appreciation on donated property as tax-exempt income;
   (c) group charitable contributions with "allocable deductions" with respect to Section 302 of the bill;
   (d) jeopardize long-established methods of charitable giving, such as charitable remainder trusts, life income agreements, and gift annuity agreements;
   (e) place a tax of 7½ percent on the investment income of private foundations;
   (f) drastically alter the tax treatment of state and local bonds, through which colleges in some states are enabled to finance capital construction
7. Putative gains in tax revenues created by the above provisions are negligible by comparison with the financial hardship such provisions would impose on American education and philanthropy.
8. The bill penalizes the whole of private philanthropy for the abuses of the unconscionable few.
9. Under present law, a donor cannot escape taxes through making charitable contributions.
10. Those retroactive provisions which would alter the tax treatment of already existing trusts and gift agreements seem especially unfair.

* Presented by Robert E. R. Huntley, President, Washington and Lee University, accompanied by Eugene H. Stockstill.

11. In considering this bill, the Senate is asked to remember the cardinal principle of educational and charitable fund raising: *in any fund-raising effort, a few large donors always give far more than all remaining donors.*

12. The real danger posed by some sections of this bill would be to the pluralistic vigor of American society and thus to the national interest.

13. Attention is called to the attached document describing private support of independent higher education in Virginia.

STATEMENT

of the

ASSOCIATION OF INDEPENDENT COLLEGES IN VIRGINIA*

concerning

TAX REFORM ACT OF 1969

(H. R. 13270)

as passed by

U. S. HOUSE OF REPRESENTATIVES

on

August 7, 1969

Independent Institutions of Higher Education in Virginia

(Not including theological or religious seminaries)

Senior (Four-Year) Institutions

BRIDGEWATER COLLEGE, Bridgewater

EASTERN MENNONITE COLLEGE, Harrisonburg

EMORY AND HENRY COLLEGE, Emory

HAMPDEN-SYDNEY COLLEGE, Hampden-Sydney

HAMPTON INSTITUTE, Hampton

HOLLINS COLLEGE, Hollins College

LYNCHBURG COLLEGE, Lynchburg

MARY BALDWIN COLLEGE, Staunton

RANDOLPH-MACON COLLEGE, Ashland

RANDOLPH-MACON WOMAN'S COLLEGE, Lynchburg

ROANOKE COLLEGE, Salem

SAINT PAUL'S COLLEGE, Lawrenceville

STRATFORD COLLEGE, Danville

SWEET BRIAR COLLEGE, Sweet Briar

UNIVERSITY OF RICHMOND, Richmond

VIRGINIA UNION UNIVERSITY, Richmond

VIRGINIA WESLEYAN COLLEGE, Norfolk

WASHINGTON AND LEE UNIVERSITY, Lexington

Junior (Two-Year) Institutions

AVERETT COLLEGE, Danville

BLUEFIELD COLLEGE, Bluefield

FERRUM JUNIOR COLLEGE, Ferrum

MARYMOUNT COLLEGE, Arlington

SHENANDOAH COLLEGE, Winchester

SOUTHERN SEMINARY JUNIOR COLLEGE, Buena Vista

SULLINS COLLEGE, Bristol

VIRGINIA INTERMONT COLLEGE, Bristol

Private philanthropy must be stimulated and promoted as the underlying foundation of the independence and integrity of our privately supported institutions–churches, colleges, hospitals, etc.–and many charitable causes and agencies. The primary support of these institutions, causes and agencies has traditionally come from private sources stimulated by tax laws which were designed to encourage philanthropic actions and develop a sense of civic responsibility.

The Tax Reform Act of 1969 (H. R. 13270) is the first significant step backward with respect to the provisions for charitable contributions during the past 56 years of income tax history. Shall the Congress, which has historically sustained and enlarged the incentives for charitable giving, now reverse its field and, in so doing, increase the financial problems of already hard-pressed institutions and organizations which depend upon voluntary support? There are literally thousands of institutions and agencies operating in the private sector that vigorously oppose such a development.

Congress has recognized that legislation is needed to remedy tax abuses and to simplify the tax code. Some of the major changes proposed by this bill fail on both counts.

The main avenues now open for tax avoidance can be closed off without affecting incentives for legitimate voluntary gift support. Could not the Congress focus its attention on abuses and not use a meat-ax when a small pruning knife would be more effective for cutting out the trouble spots?

Higher education and organized charities should not be victims of the reformers' zeal simply because they do not have the "influence" to defend themselves.

It is clear that there will be, as there should be, some kind of tax reform legislation. Tax reform is urgent; no one can condone the abuses which have existed; it is to the credit of Congressional leaders that corrective measures have been proposed. Abuses, however, are not connected with the legitimate charitable deduction provisions of the present law.

It is noteworthy that we have *not* taken exception to this bill in its entirety nor even to all of the provisions related to tax exemption and charitable deductions. Colleges are willing to sacrifice some of the traditional methods of giving if necessary to preserve others which are essential to institutions dependent upon private gift support. Indeed, the authors of this bill deserve applause for provisions to tax organizations on income received from debt-financed investments and to extend the unrelated business income tax to cover all organizations now

exempt, and it is hoped the Senate will enact such provisions. And, needless to say, we support the provision to increase the ceiling on deductibility as being consistent with the need to stimulate private support of education and social and human betterment.

1. This bill dilutes the strength of the private sector of our national life and of state and local governments through provisions that:

(a) discourage charitable gifts of appreciated property and, in some cases, completely eliminate the tax incentives for making gifts of appreciated property;

[One of the most harmful elements of the entire bill is that many critics of the charitable contributions aspects of the bill are looking only at *Title II, Subtitle A, Section 201*. By far, the aspect of the bill most damaging to colleges and other gift-supported institutions is to be found in the provisions of *Title III, Subtitle A, Sections 301* and *302*–the limit on tax preferences (*LTP*) and the *allocation of deductions*. The provisions in these sections reduce the advantage of making gifts of appreciated property by at least 50 percent. Furthermore, they would have a generally damaging effect on gift support because they disallow large portions of charitable deductions for certain donors. The *LTP* section provides that taxpayers must pay a "minimum tax" on all economic income, including so-called "tax-exempt" income. No more than 50 percent of total income can escape taxes. *And the appreciation on donated property is classed as tax-exempt income.* In *Section 302* the bill disallows portions of non-business personal deductions (including charitable deductions) where the taxpayer has what the drafters of this bill consider to be disproportionate tax-exempt income. The Congress should remove the appreciation on donated property from the classification of tax-exempt income and remove charitable contributions from "allocable deductions" with respect to *Sections 301* and *302*.]

(b) jeopardize time-honored methods of charitable giving, such as charitable remainder trusts, life income agreements, and gift annuity agreements;

(c) drastically alter the tax treatment of state and local bonds;

[In a growing number of states, colleges and universities use this source of credit to great advantage. Again, most of the damage to the sale of local bonds is obscurely tucked away in the *tax preferences* and *allocation of deductions sections* of the bill (*Title III, Subtitle A, Sections 301* and *302*).]

(d) place a tax of 7½ percent on the investment income of private foundations.

[The primary effect of this tax will be to cut back funds available to colleges, churches, hospitals, and other operations in the private sector. Such a tax has no real validity, especially in view of other restrictions on the operation of foundations as provided in the bill (self-dealing, distribution of income, ownership limitations, etc.). In view of the innovative and creative contributions foundations have made and will continue to make to the national life, it makes little sense to tax their resources and then have government replace the lost dollars with tax funds.]

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2. Putative gains in tax revenues created by the restrictions on contributions deductions ($5 million in 1970, according to the official report of the committee) are negligible when compared to the financial chaos that will result for churches, schools, colleges, hospitals, and innumerable public charities that depend on gift support to continue their services.

> [One Virginia college reports that 70% of its gift receipts in a current campaign has come in the form of appreciated property. At another Virginia college, the two largest gifts (both record gifts in their respective categories) last year were made with appreciated property. And at a third Virginia institution, what has been called the largest single gift in the history of private education was made with appreciated property. The proposed regulations on donating appreciated property will not substantially increase tax revenues.]

3. The bill penalizes the whole of private philanthropy for the abuses and excesses of the unconscionable few.

4. A basic consideration in drafting the bill was the measures thought to be used by wealthy citizens to avoid taxation. Contributions deductions in the present law are not used to *avoid* taxes. Within carefully defined limits, donors may *reduce* their taxes by virtue of the deductions for charitable contributions. Certainly the tax rewards alone cannot move anyone to give to his favorite college. There must be a donative disposition on the part of the donor. Deductions only lower the cost of charitable gifts. We fully support provisions in H. R. 13270 that would eliminate any possible profit motive for making donations–e.g., the "Clay-Brown" provision (*Title I, Subtitle B, Section 121*) and the provision relating to property gifts where any portion of the gain on the property (had it been sold) would have resulted in either ordinary income or short-term capital gain (*Title II, Subtitle A, Section 201*).

5. The allocation-of-deductions requirement in the bill would be a major factor in diminishing voluntary support of education.

6. A source of grave concern to all educational institutions and publicly supported charities is the possible impact of retroactive features of the bill, *particularly those provisions which would alter the tax treatment of already existing trusts and gift agreements.*

7. *Title II* (Individual Deductions), *Subtitle A* (Charitable Contributions) was written with a view toward removing from the contributions section of the code those "loopholes" that supposedly enable the wealthy to avoid payment of taxes through donations to charity.

Wealthy individuals do not *avoid* taxes through charitable gifts. Conforming to public policy established by the architects of the contributions deduction feature of the present code, such donors simply *reduce* their tax liability.

Present tax incentives which appeal to the wealthier donor should be considered with extreme care before changes are enacted. Any competent survey of giving patterns reveals that a few major donors always give far more than all remaining donors. Therefore, diminishing incentives for wealthy donors will cripple the fund-raising efforts of many a community, church, school, hospital, or college because the pacesetting gifts will be drastically cut back.

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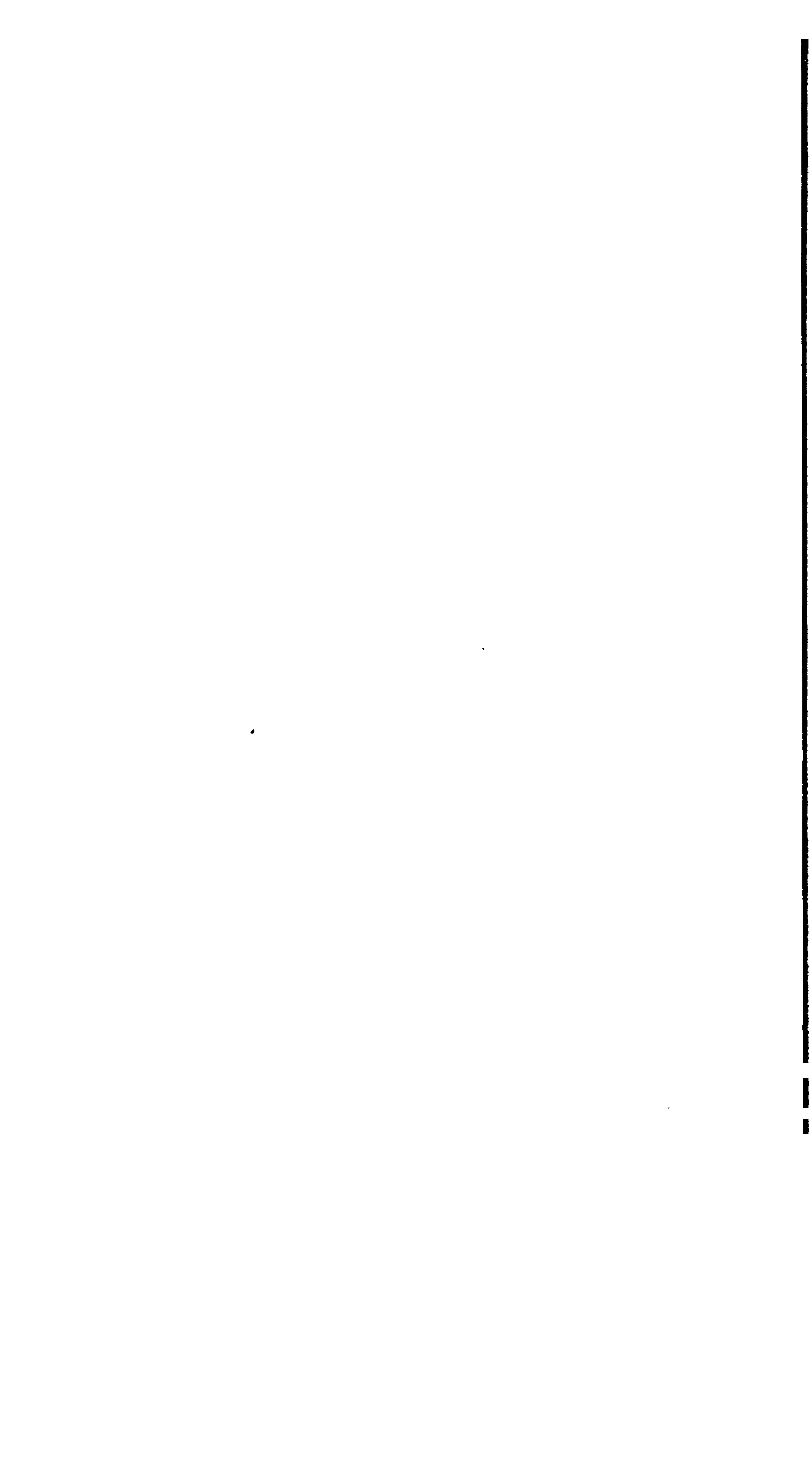
While the restrictions on charitable giving would have a devastating effect on many institutions and organizations, the real threat in this bill is to the nation and to the pluralistic vigor of American society. A real effect of these changes and even broader changes that will likely follow would be to pull more power away from the private sector and place it in the public sector.



SUMMARY

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2. H. R. 13270, if enacted in its present form, would be Congress' first major retreat from the time-honored principle that the voluntary benefactors of society and socially useful institutions should be recognized and rewarded in the tax laws The bill would strike a crippling blow financially to innumerable educational, health, religious, civic, and community organizations that are dependent on voluntary gift support.
3. Tax avoidance can be stopped without damage to the practice of philanthropy and to privately supported education.
4. Tax reform is imperative and the higher education enterprise applauds Congressional acknowledgment of this fact and the determination of the Congress to act constructively.
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   - (e) place a tax of 7½ percent on the investment income of private foundations;
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7. Putative gains in tax revenues created by the above provisions are negligible by comparison with the financial hardship such provisions would impose on American education and philanthropy
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9. Under present law, a donor cannot *escape* taxes through making charitable contributions.
10. Those retroactive provisions which would alter the tax treatment of already existing trusts and gift agreements seem especially unfair.

11. In considering this bill, the Senate is asked to remember the cardinal principle of educational and charitable fund raising: ***in any fund-raising effort, a few large donors always give far more than all remaining donors.***

12. The real danger posed by some sections of this bill would be to the pluralistic vigor of American society and thus to the national interest.

13. Attention is called to the attached document describing private support of independent higher education in Virginia.

COUNCIL OF JEWISH FEDERATIONS AND WELFARE FUNDS
315 Park Avenue South
New York, N. Y. 10010

September 18, 1969

STATEMENT BY:
COUNCIL OF JEWISH FEDERATIONS AND WELFARE FUNDS
Submitted by Louis J. Fox, President

TO:
SENATE FINANCE COMMITTEE

Regarding:
TAX PROPOSALS AFFECTING CHARITABLE CONTRIBUTIONS

SUMMARY OF PRINCIPLE POINTS

1. Gifts for welfare, health, and educational services can be seriously harmed by the effects of proposed tax changes.

2. If gifts are discouraged through reducing tax incentives, the effect would be pressures to shift financing from the voluntary sector to the government.

3. The support by charities of tax equity is affirmed. Tax equity can be attained without harm to charities.

4. The approval by charities of the proposal to eliminate and reduce taxes of persons at the lowest economic levels is affirmed.

5. Appreciated property given to charities from the list of "tax preferences" should be deleted in the proposals for "Limit on Tax Preferences" and for "Allocation of Deductions" to avoid major harm to the beneficiaries of charity.

6. Charitable deductions should be deleted from the list of deductions which would be subject to reduction as a result of allocation.

7. Gifts to charity benefit others, not the taxpayer -- and are different from the economic transactions included in "Tax Preferences" and in other deductions because of their voluntary, discretionary nature.

8. "Bargain Sales" help charities and should be permitted.

9. The full ceiling of 50 per cent should be permitted for gifts of appreciated property.

10. Government should encourage giving at all income levels and the Standard Deduction should permit supplementary incentives for contributions at the lower middle income bracket ($10,000 to $15,000) which provides almost one-fourth of income from gifts.

11. The ultimate loss of the proposed 7.5 per cent tax on foundations would be passed on in the form of reduction of services by agencies which receive funds from these sources.

12. In order not to hurt current giving, changes in tax provisions should be made effective prospectively, not retroactively.

13. Provisions affecting charity should be carefully reviewed to avoid harm to beneficiaries of charity.

14. Above all, there should be recognition that charity is not a "loop-hole."

STATEMENT BY

LOUIS J. FOX
President, Council of Jewish Federations and Welfare Funds

to

SENATE FINANCE COMMITTEE

September 18, 1969

My name is Louis J. Fox of Baltimore. I am President of the Council of Jewish Federations and Welfare Funds. The Council is the national association of Jewish united community funds in over 200 cities in which 95 per cent of the Jewish population of this country resides. The Federation in each city conducts a combined campaign for a network of welfare, health, and educational organizations and services. They include hospitals; clinics; nursing institutions, homes for the aged; family welfare agencies; treatment of emotionally disturbed children, vocational training, guidance, and placement; community centers; summer camps; and other services under Jewish auspices. The number of philanthropic agencies that depend on each community federation for support range up to 130 or more, and are national as well as local services.

Altogether, our associated Federations and Welfare Funds and other major Jewish agencies raise about $400 million annually from more than a million contributors.

Hundreds of thousands of persons depend upon these contributions to meet their vital needs -- of sickness, old age, mental disturbance, dependency, and others.

Our primary concern is the needs of these people. It is to help them that the philanthropic gifts are obtained. If gifts are

impaired it is these beneficiaries who suffer -- and they are the people who can least afford to suffer. The only alternative is a shift of financing from voluntary contributions to government through tax support.

CHARITIES FAVOR EQUITY

Charitable agencies are not opposed to minimum taxes. They are not in favor of any tax arrangement involving contributions which would result in total tax avoidance. They are certainly in favor of tax equity. It should be clear that tax reform does not hinge upon the retention of the proposals in the House bill (HR 13270) which are harmful to charities.

The charities recognize the desired impact of some provisions of the bill, such as those adjusting the taxes for persons in poverty. But other elements of the bill could do great damage to these persons, in deterring voluntary contributions upon which many sick, disabled, and others critically depend.

DONATIONS OF APPRECIATED PROPERTY

Our concern is with those provisions of the House bill which would reverse the historic policy of our nation to encourage people to give their funds for welfare needs through tax incentives, and instead would deter gifts by tax impositions.

The House bill would impose taxes on appreciation in securities and property donated to charities if the securities or property had been held by the donor less than one year; and on pro-

perty and securities held a year or longer if the taxpayer came within the "minimum tax" or "allocation of deductions" proposals. These gains are not taxed now when given to charities. They should not be taxed in the future.

The proposals to tax such gains in gifts can be eliminated from the lists of tax preferences in the "minimum tax" and "allocation of deductions" proposals without negating or weakening the desirable purposes of the two proposals.

Charities have nothing in common with the list of "tax preferences" with which they have been lumped in the House Bill -- such as excess depreciation, hobby farm losses, tax free interest on municipal bonds, untaxed capital gains. Charitable gifts should therefore be deleted from that list. The other items can be dealt with on their own merits.

Gifts of appreciated securities and property are vital to charities. A major portion of the income of a number of voluntary, charitable, educational and similar organizations, is in the form of gifts of appreciated securities and property. Any deterrent to such gifts would have most serious effects. The gifts involved are often the largest gifts.

Gifts to charity represent out of pocket decreases in the net worth of the contributors -- these gifts or donations are different from the other items called "tax preferences" which actually benefit the taxpayers involved and not charitable beneficiaries.

The beneficiaries of the gains in securities and property given as charitable donations, rather than the taxpayers, are the

people who depend on these gifts. They are the aged and the sick, families in trouble or already broken, emotionally disturbed and retarded children, and others.

The Senate Finance Committee in the past has rdcognized the harm in the House proposals. In 1938 the Committee eliminated such tax proposals from a House bill because "the Committee believes charitable gifts are to be encouraged". That position is equally valid now.

Analysis of the gifts to our associated community Federations and Welfare Funds indicates that 3 per cent of our contributors provide 70 per cent of the income and that as much as one-half of this income is in the form of appreciated property.

The inclusion of charitable contributions, particularly in the form of appreciated property, in the proposals for minimum tax and for allocation of deductions cannot be defended on the basis of logic or equity.

Any quirks in the tax laws which, under some unusual and infrequent circumstances,can result in gain to the individual taxpayer, can be corrected by a simple provision of a percentage or dollar tax floor for each individual above an agreed level. All that is sought by way of minimum tax can be obtained without including the donation of appreciated property with whatever list of "tax preferences" (those proposed or others that might be considered) are selected.

The objective of the companion proposal for "allocation of deductions" can be attained while elminating appreciated securities

from the list of "tax preference". The charitable deduction (in whatever form it is paid, cash or otherwise) should not be reduced as a result of this proposal -- such reduction would still result even if donated appreciated property were not in the tax list of "tax preferences". The present proposal in effect constitutes double jeopardy for charitable gifts where there should be no jeopardy at all.

We recognize that the proposals are designed to tax some forms of donated property at full rates and to tax other forms at partial rates under the minimum tax and allocation of deductions proposals. While the exceptions which have been proposed for partial tax involve mainly appreciated securities and realty given to publicly supported charities, this is still a major reversal of the current policies which emphasize the incentives that have helped attract generous gifts in very substantial amounts.

It would be harmful to charities to virtually bar "bargain sales" of stocks to charity; nor should there be a retroactive effective date. It would discourage the gift where the donor wishes to contribute the gain and recover his investment in his stock. If some form of minimum tax is enacted, there need be no concern regarding abuse of such arrangements.

The owner of donated realty should not be required to give the entire property, when he might be willing to give a partial interest in the property. He might choose not to give

at all if the conditions in the bill are made to onerous.

> An underlying and critically important fact is that no man is forced to give -- that, whatever the tax incentive, the individual is still giving away something he is not compelled to give. Regarding appreciated securities, the potential giver can simply retain his security and pay no tax during the retention. Thus the government would receive no revenue, and all that is accomplished is to deprive charity of the potential gift.

Another injury to charity in the House bill is that even where donated property gifts are taxed at less than the full rate, the amount of such donations would be restricted. Thus, the ceiling on tax-deductible giving would be raised to 50 per cent, but gifts of property would be restricted to 30 per cent. This will hurt charities precisely with regard to their very largest gifts.

EFFECTIVE DATES

Charities are already beginning to feel the pinch of the House proposal regarding effective dates of the proposed changes. The series of past effective dates proposed for most changes involving charitable contributions, particularly those involving donation of appreciated property and "bargain sales", jeopardizes many gifts because no contributor can know with assurance how the

tax rules will affect his giving. This is grossly unfair, whatever the final form of the bill. It has a paralyzing effect on giving. Not only should the changes in the bill in themselves not discourage charitable gifts, but the provisions of the bill as a whole should be prospective, not retroactive.

STATUS OF LOWER INCOME TAXPAYERS

We are concerned with the full income spectrum of giving and not with the largest givers alone. The income from small contributors is crucially needed in itself and today's small giver, given the motivation and the resources, can be tomorrow's medium or large size giver.

Charities will be affected also by the proposed extension of the standard deduction. This proposal will apply mainly to people in the $10,000 to $15,000 income bracket who reported gifts of $2.1 billion of the total of $9.1 billion donated by all itemizers in 1966. Instead of building greater tax inequity by permitting the same deduction for people who do not have expenses as for those who do, Congress can achieve the purpose of greater tax equity by changing the tax rates that apply to the income levels involved. It can also phase in any change in the standard deduction over a longer period than three years, as in some other proposed changes in the bill. And whatever else Congress may do about the standard deduction, it should permit charitable deductions outside the standard deduction to encourage charitable gifts. Other considerations in the standard deduction, such as tax payments, mortgage interest

charges, and the like, are costs the taxpayer must pay. The charitable gifts are different. They are voluntary acts. The gifts should be encouraged by permitting deductions for them outside the standard deduction -- and the standard deduction itself can be set at ceilings to take that into account.

GIFTS FROM FOUNDATIONS

Most agencies depend on individual benefactions for their support. For many, foundation gifts are an important source of income. While we are not testifying on the question of abuses affecting foundations, our agencies are concerned that the proposed tax of 7.5 per cent of income of foundations will be passed on to them in the form of reduced contributions.

Here again, the ultimate impact of the tax proposals would fall not on the individual taxpayer but on the persons in need of health, education and welfare services.

CHARITY IS NOT A "LOOP-HOLE"

The tax incentives for philanthropy with which we are concerned are not "loop-holes". They benefit people other than the taxpayers. They reflect the American commitment to voluntary contribution-supported welfare, health, and education programs -- programs which the government otherwise would have to support.

This vital difference needs to be recognized in considering possible changes in the tax law. Charitable contributions are distinctive because they are discretionary expenditures. They are constructive acts of citizenship. They are unselfish and designed to help other human beings.

If a number of the provisions of the House bill were to be enacted by the Congress, the inevitable result would be pressures for government to fill the gaps for human needs which must be met. Government would have greater tax burdens, with no real revenue gain, and with a consequent loss also in citizen participation in welfare programs at a time when the Administration is advocating the increase of voluntary citizen effort and support.

This need not happen. Tax equity can and should be achieved without harm to charities.

In sum, we urge that the Senate should --

1) Delete all references in the bill to tax gain on donated property, whether it be direct or indirect.
2) In addition, charitable deductions in any form (cash or otherwise) should not be subject to allocation or reduction under the Allocation of Deductions proposal.
3) Reconsider the standard deduction with a separate provision for the charitable deduction outside the standard deduction, so that charitable incentives are retained and simplification can also be attained.

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4) Delete the provision for a 7.5 per cent tax on foundations.

5) Make effective dates of tax changes prospective, not retroactive, so that current giving decisions are not delayed nor gifts thereby endangered.

6) Allow sufficient time for a careful review of all provisions affecting philanthropy to avoid irreparable harm to the persons dependent on charities.

This statement was also approved by:

American Committee for the Weizmann Institute of Science
American Friends of the Hebrew University
American Jewish Committee
American Jewish Congress
American ORT Federation
American Technion Society
Anti-Defamation League of B'nai B'rith
Hadassah
Hebrew Union College - Union of American Hebrew Congregations
American Jewish Joint Distribution Committee
National Committee for Labor Israel
National Council of Jewish Women
National Jewish Community Relations Advisory Council
National Jewish Welfare Board
United Hias Service
United Israel Appeal
Women's American ORT
Yeshiva University including Albert Einstein College of Medicine and Hospital
Other agency names to be added.

1318/9/69
fk

Federation of Jewish Philanthropies of New York

130 EAST 59 STREET
NEW YORK, N.Y. 10022
751-1000

GEORGE H. HEYMAN, JR.
STATEMENT ON TAX REFORM BILL
SENATE FINANCE COMMITTEE
SEPTEMBER 18, 1969

PRESIDENT
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CONSULTANT ON
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SUMMARY OF POINTS

1. Private philanthropies play a major role in supplementing the efforts of government to meet the health, welfare and educational needs of the people. Federation of Jewish Philanthropies raises and distributes more than $20 million annually among more than 130 hospitals, homes for the aged, child care institutions, community service centers, etc., to enable them to do their share in meeting these needs. We estimate that we serve about one and one half million people annually and contribute 23% of the philanthropic quotient by the voluntary sector of the City of New York. A substantial portion of these facilities, especially our hospitals, are located in or contiguous to ghetto areas and provide vital life-sustaining services to large segments of the population

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in the lowest socio-economic stratum. Voluntary agencies of all denominations provide a major portion of hospital facilities, locally and nationally, and, in New York City, voluntary child care facilities care for 86% of all homeless, dependent children. To the extent that voluntary agencies were prevented from providing these services, government would be compelled to assume the burden.

2. Inclusion of gifts of appreciated property in tax preferences, and all charitable contributions in allocation of deductions, is without merit or logic. A gift to charity is not simply a business transaction, and the benefit to the donor cannot be considered in a vacuum. It must be seen in relation to the benefit which accrues to the charitable donee, as well as to the community. The implicit equation of gifts of appreciated property with other so-called tax-saving devices in the group of tax preference items raises questions on the role of private philanthropy in the scale of national and social values.

3. The large donor is the backbone of private philanthropy. Seventy four percent (74%) of Federation's funds come from 5% (4,300) of its contributors (81,000). The twin disincentives of tax preferences and allocation of deductions will seriously curtail the number and volume of gifts by these large donors, with the result that private charity may find its ability to function seriously impaired. While we certainly view with favor an increase in the standard deduction, in the context of Congressional intent, to the lower and middle income

taxpayer, we cannot help but observe that such an increase may actually constitute a disincentive to giving by this group since it will provide them with the tax benefits without a concomitant financial obligation to give.

4. The continued limitation of 30% on gifts of appreciated property while the limit on other forms of charitable contributions is raised to 50% would seem to indicate a consistent desire to discourage or eliminate gifts of appreciated property. Coupled with the provisions already referred to as well as the increase in the capital gains period from six months to a year, the result may be to dry up altogether one of the most valuable sources of charitable funding.

5. The retroactive effective dates for changes relating to bargain sales and other forms of charitable giving are inequitable and damaging in their effect. Such retroactivity will not only hurt persons who have already made gifts in good faith, but will seriously hinder charitable fund raising campaigns between now and the end of the year.

6. The new category of "disqualified persons" is so loosely defined that it threatens to subject publicly supported charities to treatment as private foundations. This phrase should be more clearly defined in accordance with its apparent intent to reduce self-dealing between individuals and private foundations. Gifts for capital purposes made to organizations normally considered to be publicly supported should be excluded in determining the proportion of support obtained from so-called

disqualified persons.

7. The present unlimited charitable deduction formula should be replaced by a rule permitting every person one opportunity during his lifetime to make and obtain a deduction for an unlimited charitable contribution for capital purposes only.

8. The 7½% tax on investment income of private foundations will further reduce contributions to philanthropic organizations. As in the case of the other proposed amendments, the adverse effects upon other valid public programs and objectives may outweigh the anticipated benefits.

9. The American tradition of private citizen involvement in communal services is too valuable to risk impairment, and the Committee should therefore remove from the bill all those provisions which tend to threaten the traditional partnership between government and private philanthropy.

meb - 9/10/69

Federation of Jewish Philanthropies of New York

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TESTIMONY OF

GEORGE H. HEYMAN, JR.

on the

TAX REFORM ACT OF 1969 (HR 13270)

* * * * * * * * * * * *

UNITED STATES SENATE

COMMITTEE ON FINANCE

WASHINGTON, D.C., SEPT. 18, 1969

Whether your legacy is a hundred dollars or a million — when you leave a legacy to Federation or any of its institutions, you are an important part of the promise and progress of tomorrow

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TESTIMONY OF GEORGE H. HEYMAN, JR.
BEFORE THE SENATE FINANCE COMMITTEE
SEPTEMBER 18, 1969

Gentlemen:

My name is George H. Heyman, Jr., and I am a senior partner in the stock-brokerage firm of Abraham & Co., located at 120 Broadway, New York City. I appear here today as President of the Federation of Jewish Philanthropies of New York, an organization which raises in excess of $20 million per year from private donors, which it distributes among more than 130 beneficiary agencies.

In its 53 years of corporate existence, the Federation of Jewish Philanthropies of New York has raised $1¼ billion from private donors for the capital and maintenance needs of its constituent societies. It is our belief that we are the nation's largest private voluntary philanthropic complex. Our agencies serve the community of Greater New York, providing a wide and comprehensive range of health and welfare services, including hospital care, nursing-home care, care of the aged, child care, family counseling, vocational rehabilitation, sheltered workshops, day camps and summer camps for children and adults, and community centers. About one and one half million people of all races and creeds are served annually by such well-known organizations as Mt. Sinai Hospital, Jewish Child Care Association, Lexington School for the Deaf, Federation Employment and Guidance Service, Blythedale Children's Hospital, the Jewish Family Services of Long Island and Westchester, the Associated YM-YWHA, and many others.

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The Federation of Jewish Philanthropies is but one of a number of similar federated charitable organizations in New York. There are the Federation of Protestant Welfare Agencies, the Catholic Charities of the Archdiocese of New York and the Catholic Charities of the Diocese of Brooklyn-Queens. The existence and availability of the services provided by these major networks of voluntary agencies are indispensable to the provision of adequate health, welfare and social services to the millions of people resident in New York City and its contiguous counties. The extent of the City's dependence upon these services is measured not merely by the professional skill of the thousands of workers engaged in these activities, or by the financial contribution of the agencies to the cost of the services, but by the tremendous capital investment in plant and equipment owned by the voluntary agencies and utilized for the benefit of the community.

Thus, in New York City, voluntary agencies provide 33,198 hospital beds (including both acute and chronic care) as against 15,804 beds provided by the municipal hospital system. Capitalizing this at current construction costs in our area, the replacement value of the hospital and nursing-home beds under philanthropic auspices comes to almost $2 billion, as against less than half that for the public institutional facilities.

On a national scale, 49.8%, or almost exactly half of all beds constructed under the Hill-Burton program since 1947, are in voluntary, non-profit facilities, and the Hill-Burton program, as we know, provides no more than one-third of all project costs. In New York State, the Hill-Burton contribution has been closer to 17%.

In the field of child care, there were 24,567 dependent and neglected children being cared for in foster homes and institutions in New York City as of June 30th. Of these, 21,109, or 86%, were under the care of the voluntary agencies. While the City provides funds for the maintenance of these public charges, the rate is fixed at 90% of cost, with a ceiling on top of that, so that for many of the agencies their share of maintenance costs is far in excess of 10%.

The partnership of government and voluntary philanthropy in providing health, welfare and other social services is well established in our American society. While the ratio of government funds has, in certain areas such as hospital care, grown larger over the years, the voluntary contribution has in absolute terms also grown progressively greater. The importance of private philanthropy is particularly manifest in such voluntary agencies as community centers and our summer camps for both healthy and handicapped children, for which there is virtually no government funding. If the millions made available for these purposes by our contributors were withdrawn, these services would either be sharply curtailed

or completely terminated and the pressures on government to fill the gap would be both instantaneous and overwhelming.

I come here this morning to express my opposition to some of the proposals contained in HR 13270, the Tax Reform Act of 1969, and to give you my reasons for this opposition. First, let me say that I am in full agreement with any measure which will improve the fairness of our tax laws, or which will correct any demonstrated abuse. I am, however, deeply concerned with any proposed legislation which, suggesting that contributions by large donors to private philanthropy constitute a form of tax evasion, seeks to remake the basic tax incentives upon which rest the financial basis for the nation's private philanthropic effort. If tax incentives have been subjected to abuse, then the abuse should, of course, be controlled. But, in seeking to control the abuse, we must not make the fatal error of attacking the incentive itself. I believe that in some of its provisions, HR 13270 seriously threatens private philanthropy in this country.

1. Gifts of Appreciated Property Treated as Tax Preference
The first of these provisions is Section 301, which deals with the limit on tax preferences. Among the five items listed therein as preferences we find the following: "Any appreciation in the value of property donated to charity which is deducted as a charitable contribution, but is not included in gross income."

In my judgment, the inclusion of this item is not only unwarranted, but potentially destructive in its effect on charitable organizations such as the one I represent. Philosophically, I find it difficult to comprehend why a gift to a charity should be placed in the same category as income from tax-exempt bonds, or from capital gains, or equated with the excess of the amount of accelerated over straight-line depreciation, or so-called uneconomic farm losses. A gift to charity is not a business loss or a business gain. The reasons which prompted Congress in the first instance to allow deduction of appreciation as an incentive to charitable giving were wholly unrelated to any business considerations. To include it with deductions of a purely business or commercial character is to place the charitable contribution within a totally foreign context and to ignore the motivations and consequences which surround a gift to a school, a church or a charity.

If the Congress enacts this bill in its present form, it will in effect propound a distorted view of private philanthropic giving as a form of tax shelter with no greater social importance than the other taxpayer preferences with which it is grouped.

The thousands of successful and eminent men and women who serve on the boards of our voluntary agencies and give generously of their time, their energies, their skills and their money are clearly not motivated primarily by hope of gain. It is chiefly

from these communally-minded citizens that we receive the greatest part of our financial contributions. It is true that in making a large contribution, the expectation of a correlative tax benefit is not ignored, but this does not warrant the treatment of these individuals as mere entrepreneurs whose sole involvement is pecuniary. If that were the fact, voluntary philanthropy would in truth be doomed.

It would be of inestimable damage to the very fibre of voluntarism in the United States if the Congress were eventually to enact a tax bill from which the citizenry could infer that Congress considered private philanthropy of less social value than the tax allowance for oil and gas depletion. Yet, in its present form, the Tax Reform Act of 1969 legitimizes the view that oil and gas depletion allowances are tax incentives of greater national interest than the private support of hospitals, churches and universities, and in so doing, raises questions relative to the validity of the broad range of social responsibilities which we have been urging our fellow citizens to assume in this nation.

2. Allocation of Deduction for Charitable Contributions
For the same reasons, I take exception to Section 302, the provision relating to the Allocation of Deductions. The inclusion of all types of charitable contributions in this category creates a second penalty, in addition to the taxpayer preference, and as such both constitute disincentives to giving, affecting chiefly the large donor, the wealthy individual who is subject both to the limit on tax preferences and the allocation of deductions. Large donors are the chief source of the funds raised by the Federation of Jewish Philanthropies. Such individuals make gifts of $50,000 to $100,000 or of even $1 million or more to our building-fund campaigns.

In our last annual maintenance campaign for funds to distribute to our 130 agencies, about 74% of our money was contributed by a little over 5% of our contributors. In other words, out of more than 81,000 persons who have made contributions to our organization during this campaign year, 4,300 have accounted for $14,400,000 of the $19,250,000 so far received. This experience is typical and represents that of other federated fund raising organizations. Clearly, therefore, the large donors are the backbone of voluntary philanthropy, and without their support no major philanthropic effort such as ours can succeed.

I know this is not the intent of the bill, but if the inclusion of charitable contributions as both a taxpayer preference item as well as a deduction subject to allocation results in any substantial diminution in gifts the effects will be just as disastrous. Even a minor decline in the number or dollar value of gifts from this 5% would seriously impair our ability to function in the face of rising costs and increasing demand for our services.

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BEFORE THE SENATE FINANCE COMMITTEE
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It has been contended by some proponents of this bill that its sections relating to charitable contributions provide an impetus to increased philanthropic giving, principally by increasing the limitation on charitable deductions from 30% to 50% of the taxpayer's adjusted gross income. This view does not recognize the realities of modern economic life which generally finds that the incomes of large philanthropic donors contain capital gains or other elements of taxable income which the bill now proposes to include among taxpayer preference items. Thus, the bill, by not distinguishing between the social value of taxpayer preference items, may well provide such high-income taxpayers with every incentive to choose the preference item of the greatest economic gain to the individual and of the least social value to the nation.

Additionally, the bill actually provides a disincentive to increased charitable giving by medium-income taxpayers through Section 801 of the bill which increases the standard deduction. While we certainly favor this section of the bill as long overdue relief for this class of taxpayer, we are constrained to observe that its effect will be to discourage increased philanthropic support from this group for the simple reason that they will be getting the tax benefit of implied additional charitable contributions without having to make them.

3. Thirty-percent (30%) Limit on Deduction of Gift of Appreciated Property

A third provision of the bill to which we take exception is the 30% limitation on deduction of contributions of appreciated property which, if sold, would give rise to a capital gain. For other types of charitable contributions, the limit is raised to 50%. Taken with the inclusion of this type of gift in tax preferences and the allocations of deduction, it would seem to indicate a desire to eliminate, or at least seriously curtail, the donation of appreciated property. This view is strengthened, of course, by the treatment, in other sections of the bill, of tangible personal property, short-term gains and bargain-sales. In this respect, the bill, however, completely ignores the existence of the philanthropic recipient and solely addresses itself to the question of whether the taxpayer is deriving too great a benefit from the transaction. The charitable organizations of this country are also vitally concerned and it might well be asked whether the benefit to them, and through them to the community as a whole, is sufficiently great to warrant the continuation of an established tax incentive or inducement to giving. My experience confirms my position that the damage inflicted by this combination of restraints and penalties will, in the long run, be more damaging to the country than the benefit which may be derived from denying certain tax advantages to a relatively small number of taxpayers.

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4. Retroactivity
Aside from the merits of the provisions relating to charitable contributions, I observe that in certain instances, as, for example, bargain-sales, the effective date of the proposed legislation is retroactive. While for most provisions of the bill, the changes do not go into effect until the end of 1969, they become effective with respect to bargain-sales on May 26, 1969, and for other changes dealing with charitable contributions, the date is even earlier.

The Committee will, I hope, conclude that this is inequitable. Gifts have been made in good faith which will now be taxed under entirely new provisions. Apart from the injustice to the actual donor is the fact that persons contemplating gifts between now and the final enactment of this legislation will simply postpone such giving until the final bill is enacted. In the meantime, private charities will lose unknown amounts of desperately needed money with dire consequences to their programs and their needy clients. At the very least I urge you to remedy this most obvious inequity.

5. Definition of Disqualified Persons
It is not my purpose to propose technical changes in the bill. However, I must observe that there is a certain amount of ambiguity around the meaning of the phrase "disqualified person" under Sections 101(a) and 101(b) of the bill. Clearly the intent is to control self-dealing transactions between individuals and private foundations. The concept of "disqualified person" as now spelled out in the bill, however, may do unintended damage to institutions which are truly publicly supported. Thus, if a community center with a relatively small budget should receive a large donation for a new dormitory or a swimming pool, it may arbitrarily be reclassified as a private foundation if the one gift is more than twice as much as all the other contributions.

I would respectfully suggest that the definition of "disqualified person" be revised to preclude any such unintended consequences. In any event, gifts for capital purposes, as distinguished from gifts for operating purposes, made to organizations normally considered to be publicly supported, should be excluded in determining the proportion of support obtained from so-called disqualified persons.

6. Unlimited Charitable Deduction
I would like to allude briefly to repeal of the unlimited charitable deduction effected by Section 201(a) of the bill. Recognizing the rationale for the elimination of this privilege, I would nevertheless venture to suggest a modification which I believe would be of great public benefit and would not do violence to the basic intent of the bill in this area. In the course of a lifetime, many people acquire large sums at certain times either through fortunate investment, or through inheritance or other circumstance.

Some of these feel impelled to share their good fortune by making a large gift to a favorite philanthropic enterprise to build a hospital wing, or a staff dormitory, or for some other worthwhile purpose.

It would be regrettable if these substantial donations, generally intended for capital rather than operating purposes, were to be discouraged. In many instances, they take the place of government funds which would otherwise be required for the same purpose. I would therefore propose that, subject to appropriate regulation, every person be allowed one opportunity during his lifetime to make a gift, for capital purposes, over and above the 50% limitation on charitable contributions.

7. Tax on Private Foundations

I cannot conclude my presentation here today without some reference to Section 101(a) of the bill, calling for a tax of 7½% of the investment income of private foundations. The House concluded that this tax was desirable in part as a user fee to defray the costs of administering those sections of the bill relating to foundations and in part as an expression of the belief of the House Ways and Means Committee that private foundations should defray some of the costs of government. This tax is expected to yield about $65 million which would almost entirely be otherwise contributed to public philanthropies, such as the one I represent. I mention this to emphasize the point that the Committee cannot concern itself exclusively with the revenue-raising aspect of these proposed amendments. It must also weigh very carefully those clearly anticipated consequences which may adversely affect other valid public objectives, and then decide on balance where the public interest lies.

I am very grateful to this Committee for the opportunity you have afforded me to appear before you this morning and to express the great concern which all of us who have been engaged in voluntary philanthropy feel as we contemplate these proposals. It is my sincere wish that this Committee will view this problem, not from the relatively narrow viewpoint of individual benefits, but from the much broader perspective of the desirability of the continued participation of the private sector of our society in providing health, welfare and education services. Your Committee has a unique opportunity to give visible expression to the American tradition which continues to look to the private citizen for involvement, personally and financially, in these voluntary communal services which improve the life of his fellowman.

Thank you.

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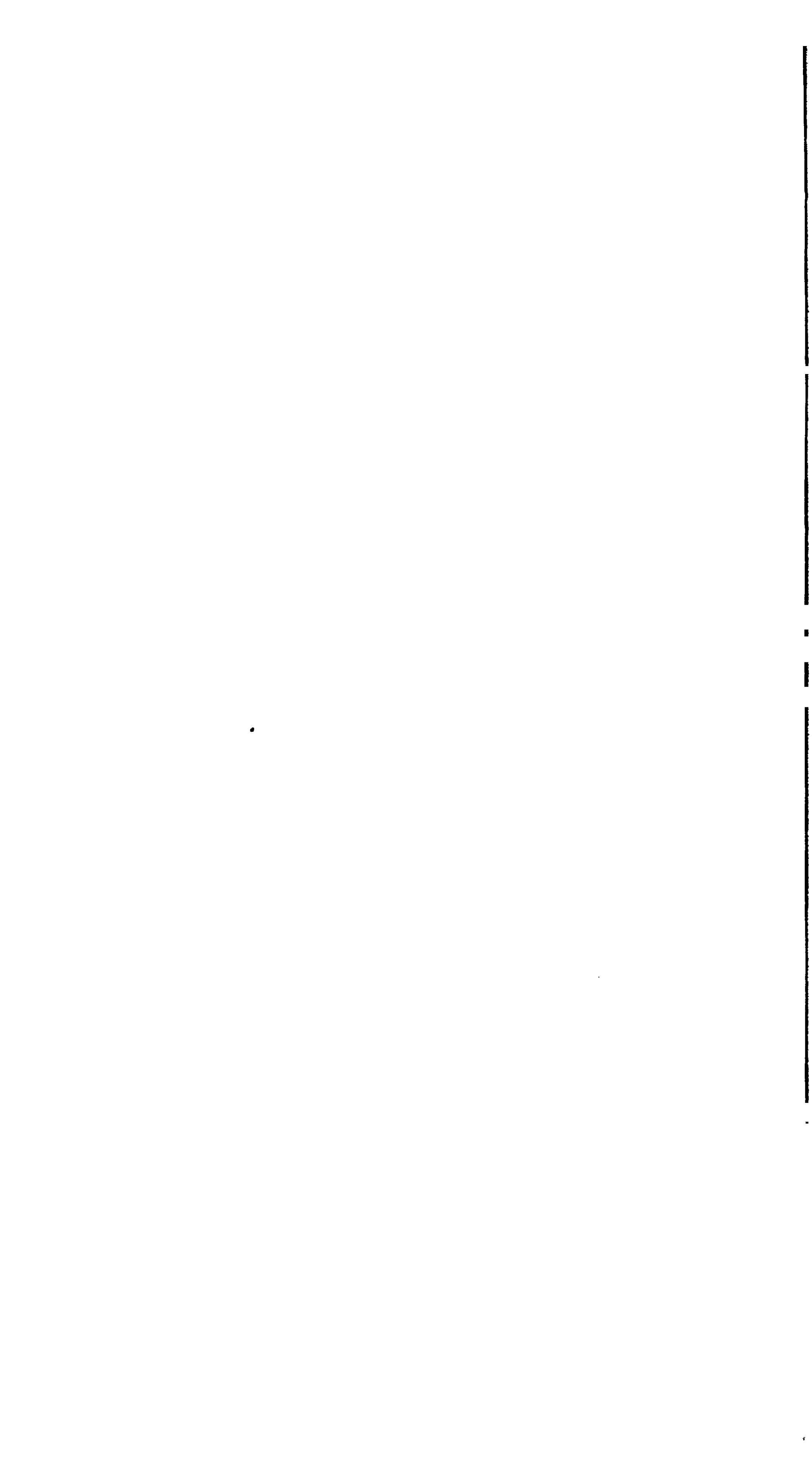

STATEMENT PRESENTED AT A HEARING OF THE SENATE FINANCE COMMITTEE
SEPTEMBER 18, 1969, BY C. STANLEY LOWELL, ASSOCIATE DIRECTOR,
AMERICANS UNITED FOR SEPARATION OF CHURCH AND STATE

Mr. Chairman, Members of the Committee:

My name is C. Stanley Lowell. I am associate director of Americans United for Separation of Church and State. This organization has been appearing for more than a decade at hearings of the Congressional committees, the Treasury Department and the Internal Revenue Service concerning tax reform, particularly in the area of religious exemptions. In order to provide guidance as to the nature and scope of this problem, our organization recently completed and published a 300-page study "The Churches: Their Riches, Revenues and Immunities." This is the first systematic endeavor of which I am aware to provide the answer to such questions as the following:

How much tax-exempt property and business investments do the churches have?

How much does this cost the average taxpayer?

What is the complete record of all the exemptions and immunities which the churches enjoy?

What reforms in this area seem to be needed?

On the basis of our study of religious exempt property in 14 typical American cities and extrapolations therefrom, we have concluded that the assessed value of religiously used exempt property in the United States now stands at about $102 billion. If one adds to this the voluntary contributions, passive income, active business income, government subsidies, and also such church assets as stocks, bonds, investment real estate, commercial business property, et cetera, he

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confronts a total of nearly $164 billion. All of this, with the exception of some real estate, is tax-exempt. Since real estate exemption for churches is a matter for local authorities, we shall confine our attention to problems arising from provisions of the Internal Revenue Code as established in 1950 and amended in 1954, and also the Regulations based thereon.

As early as November 19, 1956, this organization in testimony before a House Subcommittee on Internal Revenue urged the deletion of the exemption from income tax on "unrelated business" of churches and associations of churches as contained in Section 511 of the Internal Revenue Code. The present exemption constitutes an open invitation to churches to embark upon ventures in commercial business for profit and to operate under the shelter of the religious exemption. We warned at that time of the unfortunate consequences of such an exemption and these consequences have certainly been realized. The acquisition of commercial businesses by churches is further encouraged by the fact that at Section 6033 (a) (1) religious organizations are specifically exempted from filing returns. Some of these organizations operate in complete secrecy, not even reporting to their own members.

This tax-exempt domain is expanding at the rate of about $5 billion annually. The existence of such a large private entity immune to tax within a nation has given rise to many problems in many lands. The church never dies: hence, there is no redistribution of its holdings between generations as is the case with individuals and their estates. While we have not yet reached it, we may be actually approaching such a predicament as France faced in the eighteenth century, Britain in the sixteenth, and Mexico and Russia in the nineteenth, when a condition of "religious inflation" could only find its correction in revolution and expropriation of church property. As I said, we have not yet

reached this predicament, but we are approaching it and should take steps to prevent such a denouement.

An Invitation to Affluence

It is evident that the churches are using the religious exemptions in various ways to enhance their wealth. Indeed, the present legal situation constitutes an open invitation to do so. A church may borrow funds which it uses to purchase a business, then pay for the business out of its tax-exempt profits. Or, it may purchase the business with a very small down payment, then lease the business back to the original owners and pay for it out of current profits, immune to income tax because of the church ownership. Yet again, the church may assume title to the business on almost any terms, then hire the former owners back as managers. The profits go to the church which promptly rebates them to the managers who pay themselves for their business. The amount thus paid is subject only to the capital gains tax and escapes the higher levy on ordinary income. At the end of 10 or 20 years, the church owns the business and the managers have retained a large corpus for further investment.

Certainly the legislators did not intend that there be such a gaping hole in the tax law. Someone has estimated that if the churches really put their back into the thing, they could own the whole country in 60 years! The study by Dr. Larson and myself contains many pages describing the fortunes which churches are currently amassing under the tax shelter offered them in the present laws.

Reform Is Needed

The entire exemption at Section 511 for churches or associations or conventions of churches should be removed. We note that the bill passed by the

House has done this and we urge the Senate to keep the provision in the bill We question the wisdom of Section 121 (C) (16), however, which gives the unrelated businesses of churches continuance of their exemption for five years. This continuance simply maintains the unfair competition which these operators have posed to tax-paying operators. We urge that the same taxes be promptly imposed upon both.

Further reform is needed. Either the Code or the Regulations should draw a clear and proper distinction between related and unrelated business of churches. An absurd situation was created a decade ago when the De LaSalle Institute (corporate name of the Christian Brothers, makers and purveyors of brandies and wines) filed a lawsuit to recover income taxes on the ground that they were a church and therefore exempt. The Christian Brothers were a religious order. They argued that their brandies and wines were exempt because they were produced by an organization which technically qualified as a church or association of churches. In the case of De LaSalle Institute v. United States, Civil Action 7499, U. S. District Court for the Northern District of California, Northern Division, Judge Sherrill Halbert held against the order on the narrow ground that the Christian Brothers were not "sacerdotal" as defined in the Regulations. However, the judge went on to attack the Regulations themselves. He observed that "it would be impractical to accord an exemption to every corporation which asserted itself to be a church. Obviously, Congress did not intend to do this . . . If the doctrine of the Catholic Church were such, work in a winery might be a church function . . . . This, however, could not transform an incorporated winery into an exempt church . . . ." Unfortunately, this decision was not appealed to the Supreme Court.

Sacerdotal Test Inadequate

The years since have demonstrated the inadequacy of the so-called "sacerdotal" test. As a matter of fact, even this test has not been vigorously applied by the Internal Revenue Service. The Christian Brothers were required to pay taxes on their liquor business and have been paying them since the suit. But other religious orders, technically sacerdotal, continue to operate unrelated businesses without tax. The Jesuit order is an example. Indeed, we are not aware of any effort to impose tax, even on the nonsacerdotal religious orders operating unrelated businesses. In the awesome deference that the government continues to show to religious bodies, it has not been known to tax even those groups which have, in fact, been held to be taxable. The burgeoning of the commercial business of church organizations is the logical outcome of this reluctance.

What is needed in the light of the existing problem is a proper definition of a church. If the state is to exempt a church from tax, then certainly the state has the responsibility of defining a church. Otherwise, how would one know what is to be exempt? The definition must not deal merely with clergy ordination, but with actual functions. There must be a specific identity of purpose between the church and the trade or business it carries on. The definition of the church must focus on the basic spiritual ministries of the church and should include, specifically, the functions of worship, evangelism, education and missions. All income derived from such activities might continue to be tax-exempt, but all income not so related should be subject to tax. The fact that this income is devoted to "good causes" should carry no weight in the determination.

Other Immunities

We would also recommend the elimination of Section 107 of the Code concerning the exclusions covered under the "rental value of parsonages." Also, the exemption at Section 119 which excludes from gross income of an employee the value of any meals or lodging furnished him by his employer under certain circumstances. This exclusion of living costs, but only if they are paid for by the employer and prepared by the employees, is tailor-made for Roman Catholic clerics and members of religious orders. Since the garb they wear and the cars they drive are necessary for their professional activity, these also are tax-exempt. Scarcely anything that comes to mind would be reportable as tax income for these members of the clergy It is thus conceivable that they can enjoy the living standard of a millionaire without any tax obligation at all There is neither reason nor excuse for such immunities in a country where church and state are constitutionally separated.

There are further exemptions for the personnel of religion that should be removed. It is true that some of these are matters established by Regulations which are not in the Code itself If members of religious orders are under a vow of poverty, they have no money, work for their order, and receive mere maintenance in return. According to the existing Regulations, personnel under such a vow of poverty are not subject to withholding tax if they draw a salary from secular sources. Their check is simply transferred to the church without withholding. Thus, a member of the Jesuit order could theoretically serve as a bank president at a salary of $100,000 and not be required to make any report, much less pay any income or social security taxes. He could receive unlimited income from stocks, bonds, et cetera, held by him for the order without ever filling

out a tax report. Nuns teaching in the public schools or serving as post-office employees, and priests serving as chaplains in the armed forces or as employees of the government's welfare service-- provided they, too, are under the vow of poverty-- are in the same category They pay no taxes and simply turn their checks over intact to their orders.

The injustice of this is patent. Persons with family obligations are taxed heavily while those without such obligations pay no tax whatever. We recommend that clergymen be treated exactly the same as others by the tax collector.

Limitations on Exempts

Attention is invited to the definition of exempt organizations in the Regulations, particularly at Section 501 (c) (3). Here the limitations imposed on exempt groups are so comprehensive as virtually to destroy basic civil liberties. What is an even more serious matter, the strictures imposed here are of such a vague, though sweeping, nature that their enforcement had led to grossly discriminatory actions by the Service The use of the word "substantial" in the Regulations is a good example. It is said that an organization cannot be exempt if a "substantial" part of its income and activities are devoted to legislative or political action. This means that a large organization could engage in considerable activity of this kind with impunity, whereas a small organization could engage in none of it at all. If these prohibitions are to remain in the Regulations, they should at least be applied impartially to all exempt organizations.

Termination of Subsidies

Another significant reform which we consider imperative, but which does

not come under the purview of this committee, concerns the matter of government subsidy to church institutions. We urgently recommend the termination of all such subsidies as are derived under the Higher Education Act, the Economic Opportunity Act, and the Elementary and Secondary Education Act, et cetera, so that the churches may resume their status as voluntary societies functionally and financially separated from the state.

Require Disclosure

Finally, we recommend a substantial change at Section 6033 (a) (1) which would remove the immunity to disclosure. We urge requirement of full disclosure of church income and assets on the same basis as (c) (4) organizations. Churches should have nothing to hide; it is in the public interest to require public reports of their finances, and it is to their own interest as well. Publicity is an excellent protection against many ills. We regard Section 6050 (c) of the legislation in the House bill as inadequate. It continues to exempt church organizations from examination and audit of their finances except under rare circumstances at the request of a high-ranking official of the Service. We believe that churches should be subject to the same requirements of financial disclosure as other groups.

At various other points the House bill continues the preferred treatment of churches for reasons that are obscure. For another example, at Section 514 (b) (E) churches are given 15 years exemption from treatment as debt financed property for property designated for eventual related use, whereas other nonprofit organizations are given only 10 years exemption. Also, churches are not subject to the "neighborhood test" as are other groups. We think all should be treated alike.

Statement of Glen McDaniel,
Chairman of the Executive Committee,
of Litton Industries, Inc. Opposing Certain
Aspects of Section 421 of H.R. 13270

A Summary

Litton's major concern with §421 is the proposal to tax common stockholders who receive common stock dividends where their corporation has outstanding convertible preferred stock or convertible indebtedness. This tax may be imposed if the conversion ratio, i.e., the ratio at which the preferred stock or debt can be converted into common stock, is not adjusted upward to reflect such stock dividends. A tax may also be imposed on the common shareholder, even though no stock dividend is paid to him, if there is a decrease in the amount of common stock receivable on conversion by the holder of the convertible preferred stock or security.

The very complicated structure contemplated by §421 rests upon the erroneous presumption that convertible preferred stock or convertible indebtedness is the equivalent of common stock. A convertible preferred stock or security is not common stock, may never be converted into common stock, and possesses characteristics completely dissimilar to common stock. Some of the unsound conclusions and results which flow from this threshhold mistake are summarized below.

1. It is unfair to tax a common shareholder because of the existence of a convertible preferred stock or security.

(a) Proceeding on the invalid premise that a holder of convertible preferred stock or indebtedness is essentially a common shareholder, §421 treats any diminution in the conversion right (e.g., a decrease in the conversion rate from 1 share of preferred for 1 share of common to 1 share of preferred for .9 share of common) as being a reduction of the common stock interest of the holder of the preferred stock or the creditor and the receipt by the real common holder of an increased proportional interest.

This is simply not so. The proportional interest of the common shareholder does not change one iota by reason of a change in the conversion right; what does result from the change is a diminution in the degree of potential dilution of the common shareholder's proportional interest--an inadequate basis for levying a tax. The fact is that the proportional interest of a common shareholder does not change until actual conversion and then it goes down, not up.

(b) If the common shareholder is taxed because of changes in the conversion right and conversion never occurs, he will have been taxed on something he never received.

(c) The common shareholder cannot convert his common stock into preferred stock and thus choose between receiving a cash dividend or a stock dividend.

(d) The effect on the common shareholder is determined by the decisions of the preferred shareholder or creditor over which the common shareholder has no control.

2. Section 421 would unwisely interfere with normal corporate financing by needlessly "locking in" the parties to a full anti-dilution provision, to a fixed conversion price, to a fixed conversion rate, etc., with attendant effects upon all other aspects of the transaction; free negotiation is unreasonably inhibited.

3. Section 421 would reintroduce all of the complications of the pre-1954 law and add even additional complications. It thus reinstates, for a most uncertain revenue purpose, the problems which Congress wisely eliminated in 1954.

4. Section 421 raises serious constitutional questions.

Statement of Glen McDaniel, Chairman of the Executive Committee, of Litton Industries, Inc. Opposing Certain Aspects of Section 421 of H.R. 13270

I. A Preliminary Statement

A. The Present Law. Prior to enactment of the 1954 Code, common stockholders were taxed on stock dividends only if such stock dividends increased their proportional interest in their company. This rule was developed through various Supreme Court decisions holding that a constitutional tax could be levied only if the stock dividend resulted in a change in proportional interest. (Eisner v. Macomber, 252 U.S. 189 (1920); Koshland v. Helvering, 298 U.S. 441 (1936); Helvering v. Griffiths, 318 U.S. 371 (1943); Helvering v. Sprouse, 318 U.S. 604 (1943); Strassburger v. Commissioner of Internal Revenue, 318 U.S. 604 (1943).)

The pre-1954 proportional interest rule was complex and productive of much litigation. See, e.g., Wiegand v. Commissioner, 194 F.3d 479 (3d Cir. 1952), and Tourtelot v. Commissioner, 189 F.2d 167 (7th Cir. 1951). As a result of such complications, when the 1954 Code was enacted, Congress adopted in §305 the present rule exempting from tax all stock dividends received by common shareholders except those received as a result of an election by the stockholder to take a stock dividend rather than a cash dividend. The present rule thus eliminated the proportional interest concept as a test of taxability. As

shown later in this statement, the revenue from the taxation of dividends has not seemed to suffer from the adoption of the present rule. On the other hand, the simplification resulting from the adoption of the present rule has been a significant improvement over the pre-1954 law.

B. The Proposed Law. Section 421 of H.R. 13270 would return us, to a considerable extent, to the pre-1954 complexities, both constitutional and otherwise, by taxing a common shareholder on an increase in his proportional interest (actual or assumed) if a related cash dividend is paid to other shareholders. In fact, the proposed new rules introduce serious new complexities, mainly arising from the treatment of convertible preferred stock and convertible indebtedness as common stock.

II. Consideration of the Need for Any Change

The Report of the Ways and Means Committee states that the purpose of §421 of H.R. 13270 is to prevent a loss of revenue which could result if publicly-held corporations adopted "a capital structure with two classes of common stock so that their stock could be sold both to investors desiring appreciation and to investors desiring a current income". This same concern was expressed by the Subchapter C Advisory Group to the Ways and Means Committee in 1959 and is identified with the feeling that high-bracket taxpayers would acquire and hold

the common stock affording increased ownership of the corporation and low-bracket taxpayers, or exempt organizations, would hold the common stock paying a cash dividend.

This concern will not be relieved by the proposed amendments. A choice between stocks paying cash dividends and stocks offering equity growth will continue to be available to investors. An investor desiring income would buy the stock of a company paying cash dividends, whereas an investor desiring appreciation would invest in a company which retains its earnings for expansion and growth. The same choice frequently exists (and would still be acceptable under H.R. 13270) even within the same company, through a common stock paying no cash dividends and a preferred stock (even a convertible preferred stock if the conversion privilege is fully protected against dilution) which does pay cash dividends. The retention by public corporations of earnings certainly serves a proper and legitimate purpose of internal financing, and it would be an unsound tax policy which forces the payment of cash dividends, thereby increasing the borrowings required to serve corporate business needs.

A study of the dividend-paying habits of corporations since the adoption by Congress of the present rules raises a serious question as to the reality of the concern expressed in the Ways and Means Committee report. Attached hereto is Schedule A showing the cash dividend and stock dividend paying

practices of corporations from 1953 through 1965 as available in the Statistics of Income prepared each year by the Internal Revenue Service. These data show that the dollar amount of cash dividends has arisen each year and more than doubled during this period (from 11.6 billions to 26 billions), while the value of stock dividends paid demonstrates an absence of a growth pattern in the use of stock dividends. When one considers the fact that the value of stock dividends paid in 1953 was 1.1 billions and was 2.2 billions in 1965, during which period the Dow Jones Industrial Average almost quadrupled (250-280 in 1953 to 840-960 in 1965), it is clear that the use of stock dividends has not increased and has almost certainly decreased.

The attached Schedule B, taken from U. S. Department of Commerce data, demonstrates that the dividend paying practices of corporations have not changed as a percentage of corporate profits (although fluctuations have occurred) and, most significantly, that individuals received the same approximate percentage of their aggregate income in cash dividends in 1968 as they did in 1954 (3.4 vs. 3.2%). The 5-year averages for this period show that for 1954-1958, 1959-1963, and 1964-1968 cash dividends as a percentage of personal income were, respectively, 3.3%, 3.4% and 3.5%, while the percentage of corporate profits distributed in these periods approximated the 15-year average of 46%. These data strongly demonstrate that investors and companies have not moved to "tax-free" stock dividends. The feared impact on the revenue suggested in the House Report

simply has not developed in the 15 years since the proportionate interest test was eliminated. There is no reason to think that the future will differ from the past in this respect.

There can be no question but that the changes proposed in the taxation of stock dividends is a severe retrogression insofar as simplification is concerned. The alleged danger to the revenue is too questionable to justify the reintroduction into our tax system of the complexities inherent in the concepts of §421.

III. Treatment of Convertible Preferred Stock and Convertible Securities as Common Stock

Although a strong case can be made against the reinstatement of the proportional interest test, it is argued by some that such reinstatement is justified as an effort to extend the exception in existing law which taxes a common shareholder on his stock dividend if he has an election between cash and stock. Section 421 would accomplish this by inhibiting the creation of two classes of common stock, one paying cash and the other stock but both participating alike in equity growth and equity decreases.

Even if it is assumed that such an extension of the present law is desirable, §421 is a gross example of "overkill" in treating convertible preferred stock and indebtedness as common stock. A preferred stock, or a bond, or a debenture, even if convertible into common stock, is _not_ common stock and may never become common stock.

The lack of equivalence between common stock and a convertible preferred stock or security is plainly evident in a declining stock market such as today's: for example, a high-grade convertible bond with a face value of $100 and an interest rate of 5%, where the common stock into which it is convertible is worth $40, will sell in the market place as a debt and not as a common stock; the price it will command will be mainly the function of the yield and maturity and not its convertibility. Yet §421 treats such convertible bond as common stock.

Even where the market price of the convertible preferred stock or security reflects the market price of the common stock into which it is convertible, it is incorrect and unsound to treat such convertible stock or security as common stock on the assumption that at some time conversion will occur. Whether conversion will occur is a product of investment desires and judgment which will vary from investor to investor.

We submit that the policy reflected in §421 is unsound for the following reasons.

A. The Inequity to the Common Shareholder. The proportional interest of a common shareholder can only be decreased through the issuance of a convertible preferred stock or bond. If conversion occurs and common stock is issued to the former holder of the convertible, the old common shareholder's proportionate interest is necessarily decreased. If conversion does not occur, his proportional interest does not change.

Section 421 would tax the common shareholder on the theory that he has a "gain" if the conversion right in the convertible stock or security is decreased. This "gain", in fact, is but a diminution in the potential dilution of the common shareholder's interest. This is a totally inadequate justification for a tax.

The theory implicit in §421 that a convertible preferred stock or bond is common stock, or its equivalent, rests on the tenuous presumption that conversion will some day occur. Section 421 indeed makes the presumption conclusive, not even admitting of the possibility that conversion may not occur. Yet whether or not conversion will occur will depend on the judgment of the investor exercised in the light of economic facts. When, as is frequently the case, the market value of the convertible preferred stock or bond exceeds the market value of the common stock into which it is convertible, conversion is highly improbable.

If conversion does not occur, the common shareholder will have been taxed on the value of an "increase" in his proportional interest he did not receive. This can hardly be called fair taxation. To the contrary, when coupled with the facts that the common shareholder cannot control the preferred shareholder and has no right himself to convert into preferred stock, such a result is incredibly unjust.

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B. Interference with Corporate Financing. Convertible stock and securities have for many years played an important and respectable part in the financing by many corporations of their businesses. In the case of some companies, particularly new businesses, the use of convertible stock and securities is a "must" because lenders and investors are reluctant to risk their money unless growth equity options are also made available. In the case of practically all companies, under economic conditions such as today when interest rates are extraordinarily high, convertible stock and securities afford an essential alternative means of financing.

Section 421 unwisely interferes with this type of financing by sharply limiting the flexibility of the issuer in negotiating as favorable terms as possible. If the corporation could otherwise negotiate an exception which would permit it to pay stock dividends to its common shareholders without adjusting the conversion rate of the preferred stock or security, §421 as a practical matter makes the company forego this advantage since it would tax the stock dividend. If the conversion rate is adjusted for the stock dividend, the stock dividend is not taxable, so the corporation is "locked" into giving complete anti-dilution protection to the holder of the convertible stock or security. This hurts common shareholders and benefits lenders.

Or if the corporation could otherwise negotiate a "phase-out" of the conversion right by diminishing that right periodically, so that the potential dilution of the common shareholder's interest is minimized, the corporation would as a practical matter have to forego this significant advantage because §421 contemplates that the Treasury will impute a taxable dividend to the common shareholder by reason of the reduction in the conversion rate. The common stockholder, in this situation, is taxed even though he does not receive any more stock.

Or if the corporation could protect its common shareholders by periodically increasing the price at which a bond or debenture can be converted into common stock--a very common situation--, it would, in so doing, create an imaginary but taxable dividend to its common shareholders.

These adverse and unnecessary impediments to corporate financing result from the treatment of convertible stock and securities as common stock.

C. The Vast Complications of §421. One of the major reasons why Congress enacted the present rule in 1954 was to eliminate the complexities resulting from the then change-in-proportional-interest test of taxability of stock dividends. Section 421 will reintroduce into our system those same complexities and will further create additional complexities, arising mainly from the taxation of common shareholders because of the issuance of convertible stock and securities.

Examples of the complexities, which we respectfully submit that Congress should deal with in the statute and which §421 totally ignores, are indicated by the following questions:

1. What precisely is meant by the term "proportionate interests" as used in the proposed §305(b)(2)?

2. Since an increase in proportional interest of some stockholders would be taxed only if it is related to a cash dividend paid to other stockholders, when and to what extent will "relatedness" be considered to exist? Will the stock dividend be taxed only to the extent of the cash paid to other shareholders?

3. How will the "gain" taxed to common shareholders as a result of stock dividends imputed to them be measured? How can this be done in the case of a shareholder owning 100 shares of total outstanding shares of 35,000,000? Is the imputed "gain" likely to be realizable by the shareholder?

4. Where the conversion rate fluctuates with the market value of the common stock, and thus can go either up or down, will a common shareholder be allowed a loss where he has to "return" that portion of a conversion right which he "received", and was taxed on, in a prior year? If he is to be allowed a loss, how is the amount to be determined and what will be its character?

5. If conversion never occurs, will the common shareholder who has been taxed on the assumption that conversion will occur be allowed a loss? And what if he has sold his stock in the interim?

6. Is it intended that the law apply to situations where the amount of the stock dividend is less than the corporation's related cost in advising its shareholders?

7. Will anti-dilution provisions in convertible stock and securities give rise to a taxable gain to their holders where expressed in terms of value rather than shares?

8. Does Congress intend that corporations must give complete anti-dilution protection to holders of convertible stock and securities, or else subject their common shareholders to tax on stock dividends received by them?

9. What is Congress' intention with respect to the application of the proposed rules in light of the constitutional doctrine developed in Eisner v. Macomber, 252 U.S. 189, and later cases?

These are but a few of the problems created by §421. They suffice, however, to raise the question whether these and other complications are justified by the unfounded concern over a speculative revenue loss.

D. Revival of Constitutional Problems. The record of §421 of H.R. 13270 thus far is silent on the point, but it is plain that the amendments relating to convertible stock and securities raise serious constitutional questions.

The constitutional rules relating to the taxation of stock dividends are developed in Eisner v. Macomber, 252 U.S. 189, and the other cases cited on the first page of this

memorandum. That rule is that a stock dividend cannot validly be taxed unless it results in a change in the stockholder's proportional interest. For example:

1. A distribution of common stock on common stock, there being no other stock outstanding, cannot validly be taxed. (Eisner v. Macomber, 252 U.S. 189)

2. A distribution of preferred stock on common stock, there being no other class of stock outstanding prior to such distribution, cannot validly be taxed. (Strassburger v. Commissioner, 318 U.S. 604)

3. A distribution of common stock on common stock, there also being non-convertible preferred stock outstanding, cannot validly be taxed. (See Treasury Department's Tax Reform Proposals of April 22, 1969, Example (2), p. 223)

Section 421, of course, deals with common stock dividends paid (or considered as paid) to common shareholders where that stock dividend is related to cash dividends paid on convertible preferred stock or interest paid on convertible bonds or debentures. Section 421 thus raises these two constitutional questions:

1. Can a distribution of common stock on common stock validly be taxed where there is also outstanding a convertible preferred stock?

2. Can a distribution of common stock on common stock validly be taxed where there is no other stock outstanding but there is convertible indebtedness outstanding?

Both of these questions should be answered in the negative if the Supreme Court's decisions are to be respected. The decision of the Court of Appeals for the Second Circuit in Choate v. Commissioner, 129 F.2d 684 (1942), supports this conclusion. There, rights to acquire preferred stock, convertible into common stock at specified ratios varying from time to time, were issued to common shareholders, there also being outstanding preferred stock. The Court tested the constitutional point as though the convertible preferred stock was itself distributed and ruled that the distribution could validly be taxed. The Court stated in this connection (p. 688, fn. 12):

> "We regard as immaterial the fact that the preferred stock here is convertible, at the election of the holder, into common stock."

If the Court had treated the convertible preferred stock as common stock (contrary to the Government's position*), the distribution could not have been constitutionally taxed. The Court recognized this in distinguishing Miles v. Safe Deposit & Trust Co., 259 U.S. 247, where it was held that a distribution to common stockholders of rights to subscribe to common stock could not validly be taxed under Eisner v. Macomber.

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* The Commissioner of Internal Revenue argued in his brief that "The distribution to holders of common stock of rights to purchase shares of the Crane Company's convertible preferred stock was essentially analogous to the distribution of a stock dividend in preferred stock on common stock."

A further serious constitutional question is raised by the proposed §305(b)(3) which would tax a distribution of convertible preferred stock unless advance clearance of the Secretary or his delegate is obtained. If such a distribution were made at a time when only common stock was outstanding, it seems clear that the Strassburger decision would make a tax on the distribution unconstitutional.

Whatever would be the final result of litigation testing the constitutionality of taxing common shareholders on common stock dividends received by them, Congress should be aware that enactment of the provisions of §421 concerning convertible preferred stock and debt raises constitutional questions and makes litigation on the point inevitable.

IV. Uncertainty Arising From Broad Delegation

Section 421 gives the Treasury Department the broadest authority possible to make the substantive rules for determining whether the provisions of convertible preferred stock and debt will trigger a tax on common shareholders. The only guideline in §421 is that the stock distribution (actual or imputed) must result in an increase in proportionate interest and be related to or identified or somehow connected with cash payments to other shareholders.

If the provisions concerning convertible stock and securities are to be retained, Congress should provide the

rules. Corporations raising capital must resort to stock and securities which are responsive to economic conditions existing at the time and should be able to determine the tax consequences from the statute.

V. Applicability to Litton Industries, Inc.

At its inception in 1953, Litton formulated a policy of retaining its earnings to finance its growth. In ten years since 1959, Litton has paid a 2-1/2% stock dividend to its common shareholders, but the Company has not paid any cash dividends to the common shareholders. The Company has consistently followed its early announced policy of retaining earnings.

Of course, Litton (as other companies) has needed additional funds. It has on several occasions found it either necessary or desirable to use convertible stock or convertible securities in securing funds and continuing its growth. At an early juncture of the Company's history, the issuance of convertible debentures was the only mode by which the Company could obtain badly needed funds. This would be true of many businesses today in comparable stages of development.

When it has had to employ convertible stock or securities, Litton, of course, has always tried to negotiate as favorable terms as possible to the advantage of the corporation and its common shareholders. A prime objective of Litton in such negotiations is to minimize the dilution of the interests

of its common shareholders should conversion occur. It has done this, when possible, by trying to obtain the right to pay annual stock dividends to the common shareholders without having to adjust the rate of conversion in the convertible stock or security or by periodically increasing the conversion price. These efforts to minimize dilution of the interests of common stockholders have had no tax implications whatsoever.

During the last two years Litton has issued its Series B Convertible Preferred Stock in connection with mergers of Litton and several other companies. In the first merger in which this stock was issued, the shareholders of the other company desired cash dividends and Litton's common stock pays no cash dividends. They also wanted, however, both the chance to participate in the growth of Litton and protection against possible sharp declines in the value of the common stock.

In the course of negotiations the parties agreed that the preferred shareholders should not have the right to both the cash dividend paid on the preferred and (through the conversion right) the stock dividend paid on the common. It was accordingly agreed that Litton should have the right to continue with its annual stock dividend without adjusting the conversion rate of the preferred stock. This exemption from the anti-dilution provision was limited, however, to stock dividends up to a value of $2.00, the amount of the cash dividend paid on the preferred stock. The value of stock dividends in excess of $2.00 brings the anti-dilution

provision into play, and the conversion rate is increased to reflect this excess. Similarly, in order to maintain the proportion between the common and preferred, it was agreed that the conversion rate of the preferred should decrease if the value of the stock dividend is less than $2.00.

Litton's Series B Convertible Preferred Stock was not created for any tax reasons. In fact, the stock increased tax revenue. It is a fair stock to both the common shareholder and the preferred shareholder. No good reason occurs to Litton why its continued use should, in effect, be prohibited.

Litton's Series B Convertible Preferred Stock points up another of the deficiencies in §421. Since the conversion rate can either go up or down, dependent upon the market value of the common stock, the common shareholder could be taxed when the conversion rate goes down but gets no loss when the conversion rate goes up. In fact, during its existence the conversion rate of the Series B Stock has gone both up and down. It is entirely possible that conversion, should it occur, will be at the initial conversion rate although in the meantime the common shareholder would have been taxed on decreases in the conversion rate. This is a bizarre result.

Conclusion

The immediate reason why §421 equates convertible preferred stock and bonds with common stock is apparent. Only by regarding convertible preferred stock and securities as common stock can even a theoretical increase in the real common shareholder's proportional interest as a result of a stock dividend be developed. If the preferred stock or debt is treated for what it is--a preferred stock or debt which remains such unless and until it is converted into common stock--, then the common shareholders who receive a stock dividend own the same proportional interest thereafter as before, viz., all of the company over and above the liquidating value of the preferred stock or the face amount of the debt.

It is, however, not so apparent why the authors of §421 believe it necessary or desirable to tax a common shareholder on a stock dividend just because a convertible preferred shareholder or bondholder could not dilute the common stock, if he converts, to the same extent after the stock dividends as before.

It is evident that the characteristics of a preferred stock or a debt, even if convertible into common stock, are significantly different from those of common stock. Unlike the two-classes-of-common situation where the only difference in the two stocks is the nature of the dividend, both classes sharing alike in "ups" and "downs", no corporation would penalize

its common stockholders by creating a convertible senior stock or security solely to provide investors with a choice between stock dividends and cash dividends. The common stockholder has to share his prosperity with the convertible holder but cannot count on the latter to share his losses; he cannot become a preferred shareholder or a creditor, either to get cash dividends or interest or to put a floor under the depreciation in the value of his common stock. Even from the point of view of the convertible holder, it cannot be said that he has a free "election" where the value of his preferred stock or debt is considerably in excess of the value of the common stock into which he can convert.

Any amendments relating to stock dividends paid to common shareholders should be confined to increases in proportionate interests received by holders of common stock because of the receipt of cash or its equivalent by other holders of common stock. No amendment should be made which would tax common stock dividends to holders of common stock because of the existence of convertible preferred stock or convertible indebtedness.

However, it is apparent that a stock can be labeled "preferred" notwithstanding that it is in reality common stock. Accordingly, tests such as those proposed on pages 10-11 of the memorandum accompanying this document might be adopted to distinguish bona fide preferred stock from sham preferred stocks.

It is also recognized that what is essentially an equity interest can be labeled "indebtedness". Any such interest could be evaluated under standards similar to those suggested in case of a preferred stock.

September 16, 1969

SCHEDULE A

Cash Dividends and Stock Dividends, 1953-1965, Inclusive

Year	Cash on Property Dividends (Billions of Dollars)	Stock Dividends (Billions of Dollars)
1953	11.6	1.1
1954	11.8	1.3
1955	13.6	2.0
1956	14.5	2.7
1957	15.0	1.8
1958	15.0	1.6
1959	16.2	2.2
1960	17.2	2.0
1961	18.0	2.2
1962	19.6	2.1
1963	21.1	2.1
1964	23.3	3.1
1965	26.0	2.2

Source of Data: Statistics of Income, Corporation Income Tax Returns, Department of the Treasury

SCHEDULE B

Corporate Financial Statistics

1954 - 1968

	Personal Income (Billions of Dollars)	Cash Dividends (Billions of Dollars)	Cash Dividends As a % Of Personal Income	After-Tax Corporate Profits (Billions of Dollars)	Cash Dividends As a % Of Corporate Profits
1954	$290.1	$ 9.3	3.2%	$20.6	45.1%
1955	310.9	10.5	3.4	27.0	38.9
1956	333.0	11.3	3.4	27.2	41.5
1957	351.1	11.7	3.3	26.0	45.0
1958	361.2	11.6	3.2	22.3	52.0
1959	383.5	12.6	3.3	28.5	44.2
1960	401.0	13.4	3.3	26.7	50.2
1961	416.8	13.8	3.3	27.2	50.7
1962	442.6	15.2	3.4	31.2	48.7
1963	465.5	16.5	3.5	33.1	49.8
1964	497.5	17.8	3.6	38.4	46.4
1965	538.9	19.8	3.7	45.2	43.8
1966	587.2	20.8	3.5	49.9	41.7
1967	629.4	21.5	3.4	47.3	45.5
1968	687.9	23.1	3.4	49.8	46.4
5-Year Averages					
54 - 58			3.3		44.5
59 - 63			3.4		48.7
64 - 68			3.5		44.8

Sources of Data: U. S. Dept. of Commerce, Survey of Current Business (1967 Biennial Supplement; 1969 National Income Accounts Issue)

MEMORANDUM

Section 305 - Policy Considerations Relating To Convertible Preferred Stock And Securities

Section 421 of H.R. 13270 would amend Code §305 to provide that where a common shareholder receives a stock dividend which increases his porportionate ownership of a company, and that stock dividend is related to a cash dividend paid to other shareholders, the distribution of the stock dividend is a taxable event. Although we think that the present rules, which ignore shifts in proportionate interest as a basis for taxing stock dividends, have worked satisfactorily, we do not dispute that the conjunction of these two conditions can be considered an appropriate cause for imposing a tax. Thus, we would agree as follows with these results of H.R. 13270:

> Example 1. If A and B each own 50 shares of the common stock of Company X and on January 1, 1970, Company X pays a stock dividend to A and a cash dividend to B, there is cause for a tax to A with respect to his stock dividend since A owns more of Company X than he did before.
>
> Example 2. If A owns all the common stock of Company X and B owns all of the non-convertible preferred stock of Company X, and on January 1, 1970, Company X pays a dividend in common stock to A and a dividend in cash to B equivalent to the fair market value of A's common stock dividend, there is not adequate cause for a tax to A since he owns no more of Company X after the stock dividend than he owned before. Both before and after the stock dividend A owned all of Company X over and above the liquidating value of B's preferred stock.

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However, we disagree with the policy reflected in H.R. 13270 concerning preferred stock or debt which is convertible into common stock. Specifically we object to the conclusive presumption that a mere right to convert a preferred stock* into common stock justifies treating the preferred stock as common stock for determining whether the common shareholder has realized a proportionate increase in his ownership of the company.

Unless, of course, the convertible preferred stock is treated as common stock, the common shareholder could not be said to have an increase in his proportionate interest by reason of his receipt of a stock dividend, since both before and after receiving his stock dividend he would own all of the company's assets in excess of the liquidating value of the preferred stock or the amount of the debt. To illustrate:

> Example 3. A owns all of the common stock of Company X and B owns all of Company X's preferred stock which is convertible into common stock on a share-for-share basis. On January 1, 1970, Company X pays a cash dividend to B and a dividend in common stock to A equivalent to the value of B's cash dividend. B continues to hold his preferred stock which remains convertible on a share-for-share basis.

Under H.R. 13270, A would be taxed on his stock dividend because his proportionate interest has increased, invoking the conclusive presumption that B owns common stock and not preferred stock. In short, H.R. 13270 argues that Example 3 is the same as Example 1 which involves only common stockholders.

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* All convertibles or rights to acquire common stock are treated as common stock under H.R. 13270. Thus, convertible bonds or debentures, warrants, and rights are classed arbitrarily as common stock. We generally speak of convertible stock, but such reference should be understood to include the other affected securities.

We say, also referring to Example 3, that there is no cause for a tax to A on his stock dividend because A's proportionate ownership has not increased. B's preferred stock remains preferred stock until he converts and until then B is not entitled to participate in Company X's assets over and above the liquidating value of his preferred stock. If conversion never occurs, as frequently is the case, B's preferred stock results in no more change in ownership than the nonconvertible preferred stock in Example 2 where the stock dividend to A is not taxable.

What represents the sounder tax policy? For the following reasons, we submit that the choice should be in favor of our point of view and against the policy suggested by H.R. 13270.

1. No matter what the circumstances, the proportionate interest of a common stockholder can only be decreased because of a convertible preferred stock. If conversion does not occur, his interest remains the same, and surely he should not be taxed because his proportionate interest might have been decreased by conversion but wasn't.* If conversion does occur, his proportionate interest necessarily decreases.

Example 4. A owns all the common stock of Company X and B owns all the preferred stock which is convertible into common stock on a share-for-share basis. Before conversion, A's proportionate interest in the assets over and above the liquidating value of the preferred stock of Company X is

* If the conversion privilege expires without exercise, the consequences of taxing the common stockholder are so demonstrably absurd we presume an exception will be made. However, it is difficult to justify imposing a tax when the conversion right expires 20% a year for five years, but not imposing a tax when the entire conversion right lapses at the end of the fifth year.

100% If B's preferred stock is redeemed and not converted, A never owns less than 100%. If, however, B converts his preferred stock into common, A's proportionate interest drops to 50%.

Referring to Example 4 above, H.R. 13270 holds that if B lets his conversion right go unexercised, in whole or in part, A's proportionate interest is increased as a result thereof. This is incorrect. The real thrust of H.R. 13270 is that, even though A's proportionate interest has not increased, he should be taxed if the possibility that B could decrease A's proportionate interest by converting is either reduced or terminated.

2. The conclusive presumption of H.R. 13270 that a right of conversion justifies treating a convertible preferred stock or a convertible bond as common stock has no factual basis. Indeed, the presumption of conversion is made even where conversion is improbable. Whether or not a preferred shareholder will convert into common stock depends on economic factors and investment judgments.

Example 5. On January 1, 1970, the common stock of Company X, which pays no cash dividend but pays a 3% annual stock dividend, sells for $40 a share. The preferred stock of Company X, which pays $2.00 a year and is convertible into .7 shares of common, also sells for $40 a share. The equivalent value of the underlying common into which the preferred is convertible is $28.

Under the circumstances in Example 5, it is plain that the preferred shareholder will not convert even if the conversion right is to terminate the next day.

3. Tax laws should be explainable and a common stockholder, sophisticated or otherwise, would never understand why he should be taxed because a preferred shareholder failed to exercise his conversion privilege. He would understand (correctly) that if the preferred shareholder converts into common stock, his percentage ownership of the common stock, and thus of his company, would be less. The common shareholder would justifiably think anyone irrational who could find a profit in such a situation for him. Even if it could be said that a common shareholder theoretically owns more of a company merely because a preferred shareholder lets his conversion right go unexercised or to be reduced, it would be a rash assumption that the market place would necessarily place an increased value on his common stock.

4. The common stockholder has no control over the preferred shareholder and no right to elect between a stock dividend or a cash dividend.

5. If a tax is levied on the common stockholders on the theory that conversion has occurred and if conversion never occurs, the common stockholder has obviously been taxed on something he never got. For this reason alone, H.R. 13270 cannot be the right answer.

6. Treating a convertible preferred stock as common stock is not involved in the provisions that would tax a preferred shareholder if he becomes entitled to more shares of common stock on conversion (other than by adjustments designed

to protect the conversion right against dilution). H.R. 13270 would apparently tax a preferred shareholder on any distribution to him of stock or right to stock, whether or not that distribution is related to a cash dividend. This would not be disturbed by the argument we are making.

7. H.R. 13270 will complicate legitimate corporate financing involving convertible stock and securities and in many instances will foreclose the use of such type of financing. Convertible stock and securities have been used for many years because they minimize the cost of financing and benefit existing shareholders. Our count shows that as of April 21, 1969, there were outstanding over 700 issues of convertible preferred stock and securities, involving almost as many issuers. It would be most unfortunate if Congress adopts a policy which impedes the use of convertible stock and securities, particularly today when interest rates are extraordinarily high.

Under the policy of H.R. 13270 that a convertible preferred stock or bond should be regarded as common stock, many convertible stocks and securities used today could create significant and unexpected consequences to the common stockholders. An example is the 5-1/4% convertible subordinated debentures issued in 1966 by a large American metals company which are convertible into the issuer's common stock at $85 a share and 5% of which must be retired each year beginning in 1977.

There are at least two aspects of these debentures, mentioned below, which could (and as we understand H.R. 13270

would) create a taxable situation for the common stockholders. This situation would exist notwithstanding that the value of the debenture, if converted into common stock, is less than the value of the debenture as a debt, thus making conversion improbable.

1) The debenture holder's conversion right is protected against dilution resulting from an increase in the number of common shares, except that such protection does not extend to stock dividends on the common stock which are 5% or less of the outstanding common stock. In other words, the issuer could pay common stock dividends to its common shareholders up to 5% before the conversion rate of the debentures is adjusted. Provisions of this kind are common. Viewing the debentures as common stock, as H.R. 13270 requires, the common shareholder will be charged with getting an increase in his proportionate ownership with each stock dividend he receives up to 5%. The common shareholder would accordingly be taxed if there is a related cash dividend, and apparently the interest paid on the debentures would be regarded as a related "cash dividend".

2) The annual retirement of 5% of the debentures reduces the potential for dilution of the common shareholder's proportionate interest. That is to say, a debenture which is paid no longer exists and cannot be converted. This provision for annual retirement, also a usual type provision, is a plan of periodic retirement, similar in effect to reduction of the

conversion ratio of the entire issue, and under H.R. 13270 also would create a taxable situation for the common stockholders.

Another typical financing situation with which H.R. 13270 will improperly interfere is illustrated by the following example:

> Example 6. M Company is a growing company in the motel business. Because of its decision to finance itself to the maximum extent through earnings, it pays no cash dividends and in lieu thereof pays an annual stock dividend of 3%. In order to raise $100,000,000 to build new motels, it negotiates with a group of banks for a loan. The banks agree to lend at a rate of 9-1/2%. The interest requirements would severely hamper M Company so it enters into negotiations for a lower interest rate with the debt being convertible into its common stock. A tentative interest rate is set at 6.5%. However, M Company wants its annual 3% stock dividend to be excused from the provision protecting the creditor's conversion right from dilution because of an increase in the outstanding common shares. The banks agree but insist on a compensating increase in the interest rate to 7%.

In Example 6, the common shareholders of M Company have "paid" for their stock dividend through the higher interest rate but are able to preclude the further dilution of their ownership which would result from adjusting the conversion rate for the stock dividends. Under H.R. 13270, this would no longer be feasible since the stock dividends would be taxable. M Company would, as a practical matter, have to give its creditors 100% protection against dilution, thus increasing the common shareholder's exposure to dilution.

Conclusion and Recommendations

In our judgment, the considerations stated above show that it would be unwise and unsound to tax a common shareholder with respect to stock dividends received by him (actually or constructively) because of the existence of a bona fide convertible preferred stock or security. We recommend that the contrary policy reflected in H.R. 13270 be abandoned.

It is stated on page 116 of the Report of the Committee on Ways and Means that the purpose of the proposed amendments to §305 is to deter publicly-held corporations from adopting "a capital structure with two classes of common stock so that their stock could be sold both to investors desiring appreciation and to investors desiring a current income". The soundness of this objective is highly questionable. It is in the public interest for corporations to be allowed to finance themselves internally through retained earnings to the maximum extent possible.

Assuming that the concern expressed by the Committee deserves alleviating, the remedy should not go beyond that concern--that is, the remedy should apply only to situations involving two classes of common stock and should not extend to situations where the second class of stock is "true" preferred stock. This is true even if the investor can convert his preferred stock into common stock, because conversion will be

entirely a product of investment judgment exercised in the light of numerous market factors. The decision whether to convert or not to convert will not depend on just whether the holder wants a cash dividend or a stock dividend.

We recognize that it is possible to characterize a stock as a preferred stock when, in essence, it is a common stock--e.g., a "preferred" stock whose only preference is a $1.00 liquidating value. Obviously, such a stock will be regarded in the market place as a common stock.

Accordingly, we recommend:

1. Section 421 of H.R. 13270 should be amended to exclude as a taxable distribution of stock to a common shareholder any stock distribution which is related to a cash dividend paid with respect to convertible preferred stock.

2. For purposes of 1 above, §421 of H.R. 13270 should also be amended to provide that a preferred stock is a stock possessing the following characteristics:

(a) The stock cannot be redeemed until five years after issuance.

(b) A fixed cumulative cash dividend is payable at least annually in preference to cash dividends on the common stock.

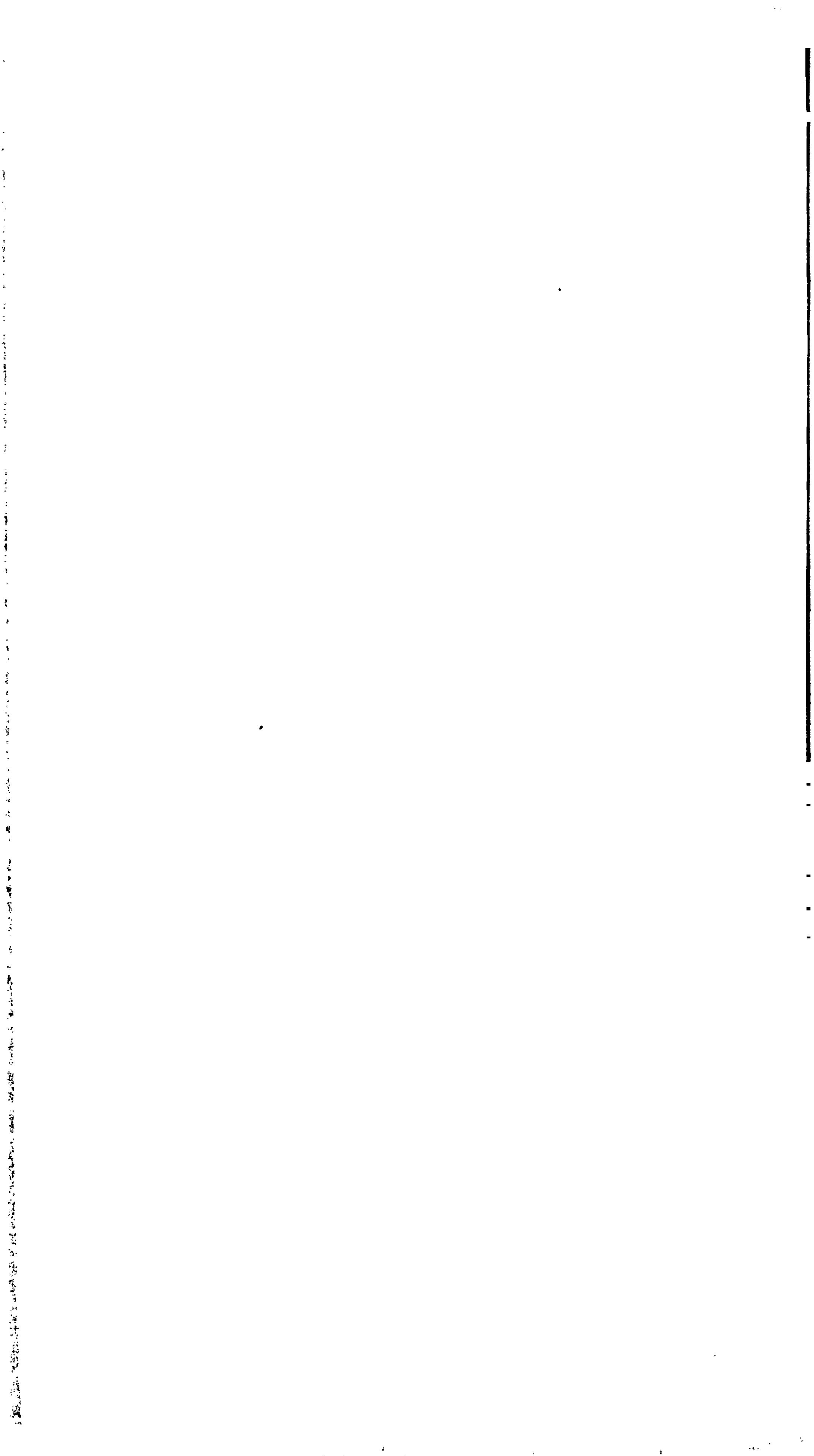
(c) The stock has a preference in the event of liquidation, and such preference is established at an amount which is, as of the

time when the preferred stock is initially issued, at least 110% of the book value of the common shares into which the preferred stock is convertible.

(d) The redemption value is established at an amount which is, as of the time when the preferred stock is initially issued, at least equal to the fair market value of the property exchanged therefor. If the redemption value equals the fair market value of the property exchanged therefor at any time within the 12 months preceding the exchange, this test will be deemed satisfied.

A stock which does not possess these characteristics, even though it is called preferred stock and is listed as a preferred stock, would be treated as a common stock for purposes of §305. Appropriate standards can, of course, be provided for convertible bonds.

August 22, 1969



STATEMENT OF
EMPLOYEE RELOCATION REAL ESTATE ADVISORY COUNCIL
ON MOVING EXPENSE PROVISIONS OF H.R. 13270
September 18, 1969

SUMMARY OF RECOMMENDATIONS

1. The 20 mile test of existing law should be retained. The substitution of a 50 mile test (p. 161, lines 19 and 23 of the bill) assumes an unreasonably long commuting pattern for employees whose principal place of work is changed.

2. The new moving expense rules should apply beginning with calendar year 1969, rather than with 1970 as proposed in the bill (p. 164, line 22, and p. 165, line 2). The Treasury Department last April 22 recommended a 1969 effective date. There is no sound reason for continuing until next year the existing inequities which, since the early 1960s, have plagued industry and government employees whose job locations are changed.

3. The overall dollar limitation of $2,500 on the three new catories of deductible moving expenses is grossly inadequate in many cases to cover reasonable moving expenses falling into the three new categories covered by the bill. Selling commissions and closing costs on a $30,000 home, for example, can easily use up more than $2,000, leaving little, if anything, for house hunting trips, temporary living expenses, and out-of-pocket costs incurred in acquiring a house at the new job location.

Specifically, ERREAC recommends the following limitations on the new categories of moving expenses:

a. Residence Sale - For reasonable expenses incident to the sale or exchange of the employee's former residence (p. 159, lines 14-20 of H. R. 13270), the limitation would be the smaller of 10 percent of the actual sales price of the residence or $5,000. This limitation is the same as provided at p. 26 of Bureau of the Budget Circular No. A-56, Revised October 12, 1966 for reimbursement of Federal civilian employees moving at the request of the Government.

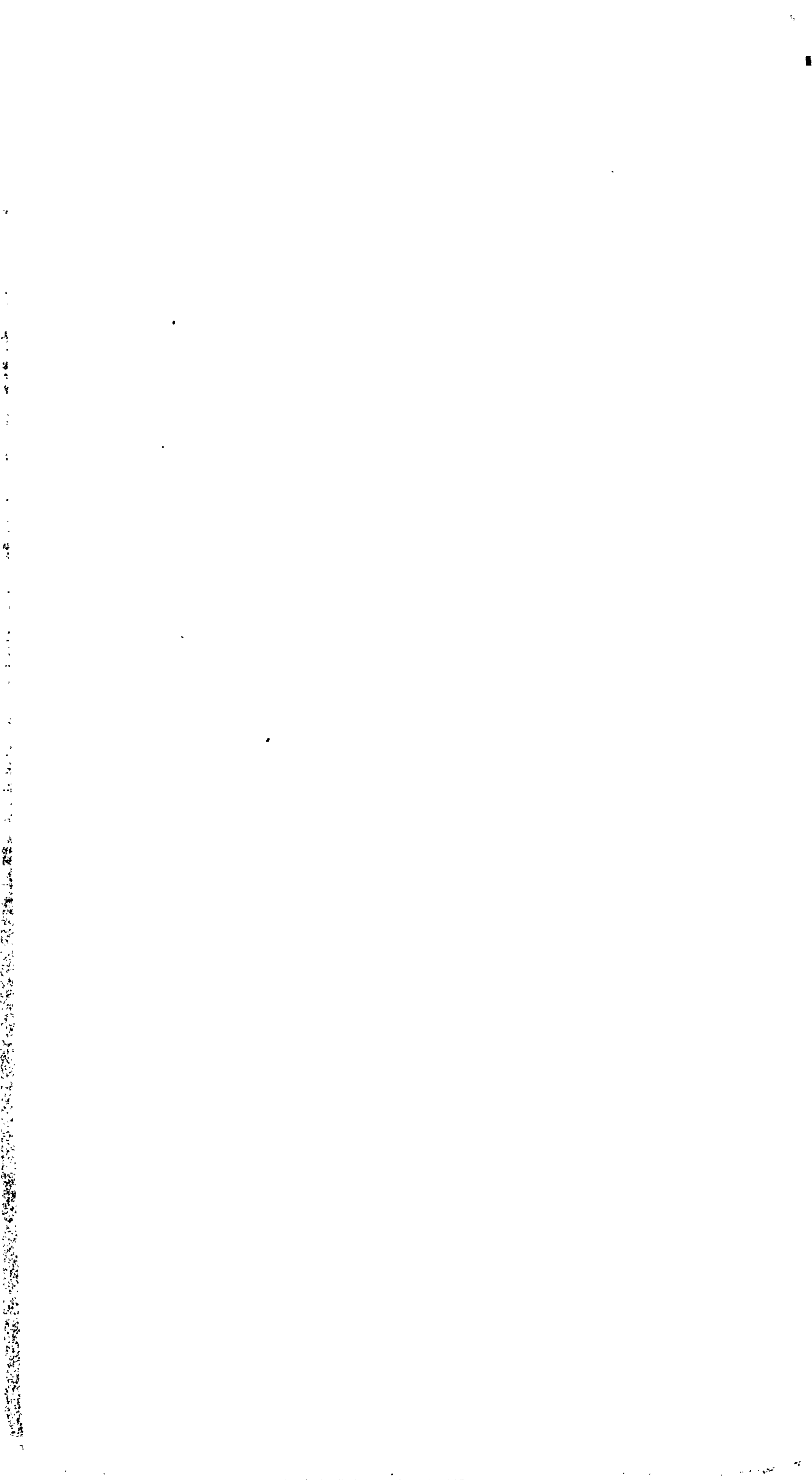
b. Residence Purchase - For reasonable expenses incident to the purchase of a new residence in the general location of the new principal place of work (p. 159, lines 21-25) the limitation would be the smaller of 5 percent of the purchase price, or $2,500. See Budget Bureau Circular No. A-56, p. 26.

c. Residence Lease - The Bureau of the Budget regulations under Civil Service reimbursement law (P. L. 89-516) do not set forth specific dollar limitations for expenses incident to the settlement of an unexpired lease on the employee's former residence, or for the acquisition of a lease on a new residence in the general location of the new principal place of

work (p. 160, lines 6-13). A reasonable dollar limitation in these areas would be $1,500 for settlement of an unexpired lease and $750 for the acquisition of a lease on a new residence.

d. House Hunting Trips and Temporary Living Expenses - For the combination of house hunting trip expenses and temporary living expenses up to 30 days at the new job location (p. 158, beginning with line 24 through p. 159, line 7, of H. R. 13270), the limitation of $1,000 now set forth in the bill (p. 160, lines 15-20) appears reasonable at this time. The regulations under the Administrative Expenses Act of 1946 do not specify overall dollar amounts for these items, but instead apply per diem allowances, and specify the maximum duration of the house hunting trips. Budget Bureau Circular No. A-56, pp. 17 and 20. Limitations of this type, while representing a reasonable approach, might be difficult for the IRS and for employers to administer and are not recommended by ERREAC for this reason.

4. The report of the Finance Committee should eliminate the confusion created by the House report with respect to the withholding requirements pertaining to reimbursed moving expenses. Section 3401(a)(15) expressly excludes from withholding amounts reimbursed to the employees which are deductible by the employees under section 217.



STATEMENT OF HOWARD M. LEE, PRESIDENT
EMPLOYEE RELOCATION REAL ESTATE ADVISORY COUNCIL
BEFORE THE
SENATE FINANCE COMMITTEE
ON THE
MOVING EXPENSE PROVISIONS OF H.R. 13270
SEPTEMBER 18, 1969

ERREAC (Employee Relocation Real Estate Advisory Council) strongly supports the enactment of legislation along the lines of §231 of the Bill to keep our Government from unjustifiably inflicting tax hardship each year on an estimated half million employment related family moves (including military, civil servant and private business).

ERREAC was formed by representatives of private industry in 1963 to facilitate and promote the exchange of information among those responsible for the relocation housing programs of their respective companies. At this time, ERREAC's membership consists of more than 250 U.S. corporations, including many of the Nation's major employers. Over the past 5 years, the purpose of ERREAC has broadened to include the study and development of methods and procedures whereby the sale of homes by employees who are transferred by their employers to different geographical locations may be accomplished with a minimum of economic loss to the employee and his employer. Membership in ERREAC is open to all companies who transfer employees from one job location to another and who are interested in furthering the study and solution of the problems

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encountered by relocated employees, with particular emphasis on the acquisition and disposition of their homes.

For the past 3 years, ERREAC has actively supported the efforts of a large bipartisan group of Congressmen and Senators to obtain urgently needed corrective legislation dealing with the tax treatment of moving expenses. The ERREAC membership is most appreciative of the efforts of the many Congressmen and Senators who have taken an active interest in the moving expense problem.

The problem which §231 of the Bill would meet is very simple. Day in and day out, thousands of Americans are expected by private business or by the Government to pack up and move from one part of the country or world to another. These are not optional moves. For those who value their jobs and careers they are for the most part compulsory. They are dictated by the needs not of employees, but of employers.

Such moves may be the result of an opening of a new installation,.a change in location of corporate headquarters, a transfer from one office or plant to another, or any one of a number of other valid and important business reasons. In general, employees who are transferred by private industry are not wealthy people; they are middle income, lower and middle echelon employees--salesmen, engineers, and the like--earning between $7,000 and $15,000 a year. In many cases--perhaps as many as two-thirds, according to ERREAC estimates--the moves are not connected with a promotion.

They may involve a sidewise or lateral job opportunity for the employee. This is particularly true in the case of a mass move brought about by the opening or closing of a plant or other major facility.

Also, according to a 1968 survey by Atlas Van Lines, most transferred employees of major corporations tend to be young--about 40 percent are between 25 and 35 and nearly two-thirds are under 45--and most must anticipate moving several times during their job careers.

Regardless of the reason for the transfer or the age or salary level of the transferred employee, business-related family relocations have one thing in common: They entail a great deal of expense.

Among the many costs involved are:

1. The expense of transporting family members and household goods to the new job location (including temporary storage).

2. The costs of selling a house or terminating a lease at the former location.

3. The cost of searching for a residence at the new location.

4. Meals and lodging for the employee and his family while awaiting arrival of their furniture or availability of their residence.

5. Expenses incident to the purchase of a residence at the new place of work, such as legal fees, title search, recording fees, and so forth.

6. Loss suffered by the transferred employee on the sale of his old residence for less than its fair value because of the necessity of selling his home and moving to the new location without delay.

7. Miscellaneous or incidental expenses resulting from the move, such as forfeited tuition fees, costs of disconnecting and reconnecting appliances, and the like.

For many years private industry has recognized the importance of being able to move employees from one geographical location to another, and that to achieve such job mobility, it is necessary to reimburse their employees for all or most of their moving expenses of the types proviously mentioned.

In 1966, with the enactment of Public Law 89-516, the Federal Government was at long last authorized by Congress to adopt moving expense reimbursement practices similar to those prevailing in private industry, including reimbursement for one round trip to the new location for the employee and his spouse to search for a residence, living expenses for the employee and his family for a period of 30 days while occupying temporary quarters, real estate expenses resulting from the transferred employee's sale or purchase of a residence, or settlement of a lease on rented quarters, and a flat allowance to cover miscellaneous moving expenses. In effect, subject to certain limitations, the Federal Government's reimbursement practices were brought into line with those of private industry, with the single exception that the Government was not permitted to reimburse for "house losses" (item 6 above for private industry).

Unfortunately, the efforts on the part of responsible employers, both Government and private, to ease the financial hardship to the employee who is moved for the business convenience of the employer have been partially thwarted by the Internal Revenue Service and the courts.

Under the Internal Revenue Code, as interpreted (at the insistence of the Internal Revenue Service and the Justice Department) by the courts in recent cases such as Bradley v. Commissioner, 324 F. 2d 610 (4th Cir. 1963); England v. United States, 345 F. 2d 414 (7th Cir. 1965); Ritter v. United States, 393 F. 2d 827 (Ct. Cls. 1968); and Commissioner v. Starr, 399 F. 2d 675 (10th Cir. 1968); it is now all too clear that reimbursement of moving expenses, other than actual transportation costs and subsistence while en route, results in taxable income to the employee.

The legal theory which permits this result is that the reimbursed employee has received a taxable benefit because he is better off financially than he would have been had he been forced to move without reimbursement. The net result, however, is that the Federal tax collector under existing law is subjecting thousands of employees to serious financial loss, even as their employers, including the U.S. Government, are doing their very best to prevent such hardship. This absurd and grotesque result must not be permitted to continue. It is unrealistic and unfair that an employee should be taxed on reimbursed expenses which the employee would not otherwise have

had except to accommodate his employer.

Some prosperous companies, it is said, can ameliorate this problem by paying a transferred employee an allowance over and above his moving expenses to cover the tax imposed by the Internal Revenue Service on most of the reimbursed items of expense. This can and is being done in greater or lesser degree by many ERREAC members. But is it a sound procedure for the Government to force the cost of employee moves up by such a tax "gross up"?

This increased cost factor, aside from its inflationary features if passed on to the employer's customers, can only discourage labor mobility to some degree.

On the other hand, what about the employees of smaller or less prosperous companies which may not be able to afford the employee's tax bill (including the tax on a tax)? And what about the employees of the Federal Government which is barred by law from reimbursing them for income taxes incident to reimbursed relocation costs? For all such employees, the taxation of reimbursed moving expenses seriously dilutes the benefit of the reimbursement, and job mobility necessarily suffers. Moreover, the present situation would appear to discriminate unfairly against them as compared to the employees of large, financially strong corporate employers.

For the above reasons and others, and because the inequities of the present harsh Internal Revenue Service position are so readily apparent, there has been a ground swell of

support in Congress for liberalizing the moving expense tax rules.

ERREAC, in accordance with the unanimous vote of its board of directors last December, strongly supports the provisions of §231 of the Bill which expand the definition of deductible moving expenses for employees now set forth in section 217(b) of the Internal Revenue Code to include:

(a) A pre-move house hunting trip or trips by the employee and members of his household;

(b) Temporary living expenses at the new employment location for not more than 30 days while awaiting occupancy of permanent quarters;

(c) Selling commissions and other expenses incident to the sale of the employee's old residence or to the settlement of an unexpired lease on the employee's old residence;

(d) Out-of-pocket costs incident to the purchase or rental of a residence at the new job location.

Addition of the above categories to the already excludable or deductible "bare bones" transportation costs of present section 217 will be a substantial forward step in assuring fair tax treatment for relocated employees. Moreover, as the bill covers all transferred employees, whether reimbursed or not, on an equal footing, a past Treasury objection against having the bill cover only reimbursed employees has been eliminated.

While applauding the proposed addition to the Code of the new categories of deductible moving expenses, ERREAC takes exception to four deficiencies in the Bill which it is hoped will be corrected by your Committee.

1. The overall limitations of $2,500 per move on the new deductions is too low for the average transferred employee who owns a house. Thus, this $2,500 limitation on the deductible expenses in the new categories for the home owner barely covers selling commissions and closing costs on disposal of a $30,000 home, leaving very little for the house hunting trip, temporary living expenses and out-of-pocket expenses incident to the acquisition of a residence at the new job location. The very modest nature of the $2,500 allowance is also evidenced by the fact that for selling expenses on the old residence alone, civilian Government employees may be reimbursed (under the amendments made by Congress in 1966 to the Administrative Expenses Act of 1946) up to 10 percent of the sales price of the house or $5,000, whichever is the smaller amount.

With continuing inflation, the flat dollar ceiling in the Bill which is already inadequate will become increasingly a source of irritation and frustration to transferred employees. ERREAC recommends, therefore, that flexible limitations similar to those provided for reimbursement of relocated Government employees under the Administrative Expenses Act

of 1946, as amended in 1966, be substituted for the overall dollar limitation of the Bill. See appendix A for ERREAC's specific suggestions on appropriate limitations.

2. Under present law, a deduction for moving expenses is allowed if the taxpayer's new principal place of work is located at least 20 miles farther from his old residence than was his former principal place of work. The Bill would increase the 20 miles test to 50 miles.

Many members of ERREAC are very much concerned about this proposed increase in the mileage test for qualifying for deduction of moving expenses. For any major company with many individual business locations scattered throughout the country, the effect of this change is most undesirable. The net effect is that unlucky employees who may already be commuting a considerable distance to work are expected to increase the commute up to 50 miles each way every working day if their place of work is changed, rather than move closer to the new job location.

We believe this is completely unrealistic. By way of example, under the proposed legislation, an employee living in Brigham City, Utah and working in Ogden (about 22 miles apart) would be denied a moving expense deduction if he moved to the Salt Lake City area (35 miles from Ogden and about 53 miles from Brigham) because of a transfer of his principal place of work to Salt Lake. And a man living any place between Dover and Wilmington, Delaware and working in Wilmington would get no deduction for moving expenses if required to move to the far side of Philadelphia because of a job connected transfer.

What it comes down to is what is a normal and reasonable commuting distance for the average employee given today's clogged highways and inadequate transportation facilities? Should a man living in the Washington area be expected to commute daily to Baltimore or Annapolis, regardless of the inconveniences, or would a reasonable man move his residence to reduce the time and distance of the commute? Based upon such standards, we believe the proposed 50 miles test is completely unreasonable. While there is no particular magic to the present 20 miles test (determined incidentally by the IRS on a straight line basis, irrespective of obstacles such as bays, rivers, lack of roads, etc.), at least it permits the deduction of moving expenses on a basis which the average man and the Treasury Department feel to be within the bounds of reason. Moreover, to the extent mobility of labor is regarded as desirable, the proposed 50 miles rule would obviously have a negative effect on those employees who are being asked to move to new job locations between 20 miles and 50 miles farther from the old residence than were their old job locations.

3. The new proposals (both those ERREAC which supports and those we find objectional) apply with respect to moving expenses paid or incurred in taxable years beginning after December 31, 1969. ERREAC strongly recommends that the liberalizing changes apply to moves made in 1969, as recommended by the Treasury Department last April when it

first presented its tax reform proposals to the Ways and Means Committee.

From a procedural standpoint, one thing that apparently delayed action on moving expense legislation during 1966, 1967 and 1968 was the absence of a formal Treasury Department report on the many pending bills. This deficiency was taken care of early this year. Under such circumstances, ERREAC strongly recommends that the obvious inequities in the taxation of moving expenses not be permitted to continue beyond the date proposed by the Treasury Department last April. In fact, in all fairness to Federal Government employees and to those in industry not fully reimbursed for the expenses of their jobs connected moves, a good case can be made for applying the change retroactively to 1966.

4. With the three modifications outlined above, ERREAC supports the enactment of §231 of the Bill. However, it should be pointed out that the Bill fails to cover two categories of moving expenses which are frequently the subject of reimbursement in the case of employer directed moves in industry. These are "miscellaneous moving expenses" and "house losses."

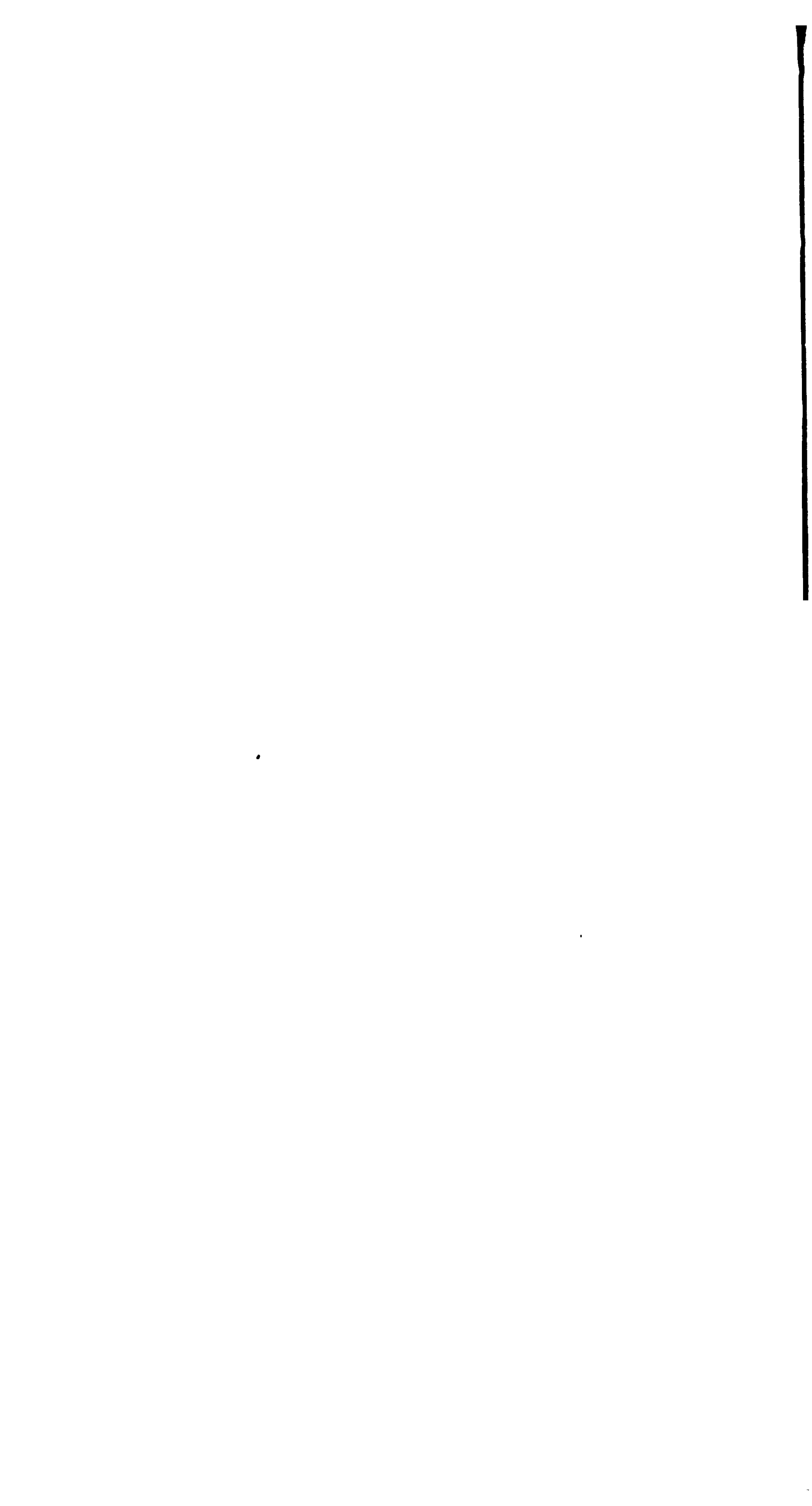
One of the amendments made by Congress in 1966 to the Administrative Expenses Act of 1946 authorized the reimbursement of so called miscellaneous moving expenses for civilian

Government employees through an allowance related to the employee's salary and family status. P.L. 89-516. ERREAC believes that the regulatory and statutory conditions, requirements and limitations on the payment of the miscellaneous moving expense allowance to a transferred employee of the Federal Government can appropriately be adopted in providing a deductible "miscellaneous moving expense category" for all relocated employees. Thus, a miscellaneous expense category could be added to the Bill providing for a maximum deduction equal to one or two weeks' pay depending upon family status, with the overall deduction being limited by the maximum pay scale for Grade GS-13.

ERREAC also suggests that at an appropriate time the committee should consider adding a house loss category to the list of moving expense categories receiving favorable tax treatment. To avoid possible abuse, it may be necessary to limit the availability of the house loss deduction to those cases where the loss is reimbursed by the employer and there is, hence, a built in, self policing device. This provision would be similar to that approved by the Senate in 1964, but eliminated in conference, in connection with the consideration of the Revenue Act of 1964.

Finally, we would point out that confusion has been created by the unqualified statement at page 77 of the Ways and Means Committee Report on the Bill that moving expense reimbursements are wages subject to the withholding provisions of section 3401(a) of the Code. As we understand it,

section 3401(a)(15) specifically excludes from any withholding requirement those reimbursed moving expenses which it is reasonable for the employer to believe are deductible by the employee under section 217. We believe it would be helpful if the Senate Report could include an appropriate reference to section 3401(a)(15) at the point the tax treatment of reimbursements is discussed.



Appendix A

Proposed Substitution of More Flexible Limitations by Category of Moving Expenses for Overall Limitation of $2,500 Provided in Bill

ERREAC recommends that the Bill's overall limit of $2,500 on the deductibility of the new categories of moving expenses (with expenses related to house hunting trips and temporary living expenses being limited to $1,000 of the $2,500) be modified to apply separate limitations on a category by category basis rather than on an overall basis and to provide more flexible limitations with respect to expenses incurred on the sale and purchase of a residence. The new limitations would be similar to the limitations provided for these items under the Administrative Expenses Act of 1946, as amended in 1966, by P. L. 89-516, when the Federal Government reimburses moving expenses of its transferred employees.

Specifically, ERREAC recommends the following limitations on the new categories of moving expenses.

1. Residence Sale

For reasonable expenses incident to the sale or exchange of the employee's former residence (p. 159, lines 14-20 of H. R. 13270), the limitation would be the smaller of 10 percent of the actual sales price of the residence or $5,000. This limitation is the same as provided at p. 26

of Bureau of the Budget Circular No. A-56, Revised October 12, 1966 for reimbursement of Federal civilian employees moving at the request of the Government.

2. Residence Purchase

For reasonable expenses incident to the purchase of a new residence in the general location of the new principal place of work (p. 159, lines 21-25) the limitation would be the smaller of 5 percent of the purchase price, or $2,500. See Budget Bureau Circular No. A-56, p. 26.

3. Residence Lease

The Bureau of the Budget regulations under Civil Service reimbursement law (P. L. 89-516) do not set forth specific dollar limitations for expenses incident to the settlement of an unexpired lease on the employee's former residence, or for the acquisition of a lease on a new residence in the general location of the new principal place of work (p. 160, lines 6-13). A reasonable dollar limitation in these areas would be $1,500 for settlement of an unexpired lease and $750 for the acquisition of a lease on a new residence.

4. House Hunting Trips and Temporary Living Expenses

For the combination of house hunting trip expenses and temporary living expenses up to 30 days at the new job location (p. 158, beginning with line 24 through p. 159, line 7, of H. R. 13270), the limitation of $1,000 now set forth in the bill (p. 160, line 15-20) appears reasonable at this time. The regulations under the Administrative Expenses Act of 1946 do not specify overall dollar amounts for these items, but instead apply per diem allowances, and specify the maximum duration of the house hunting trips. Budget Bureau Circular No. A-56, pp. 17 and 20. Limitations of this type, while representing a reasonable approach, might be difficult for the IRS and for employers to administer and are not recommended by ERREAC for this reason.

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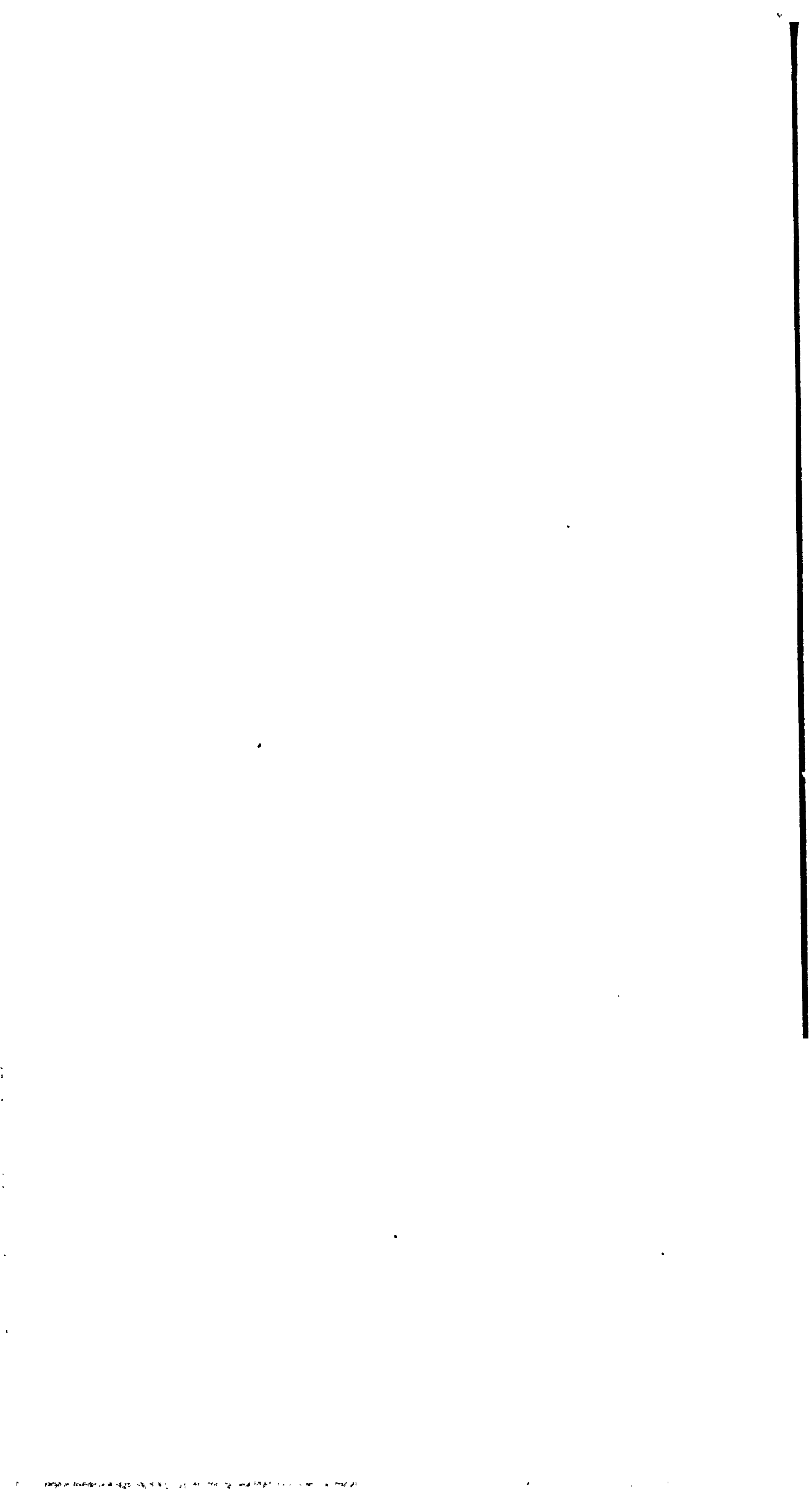
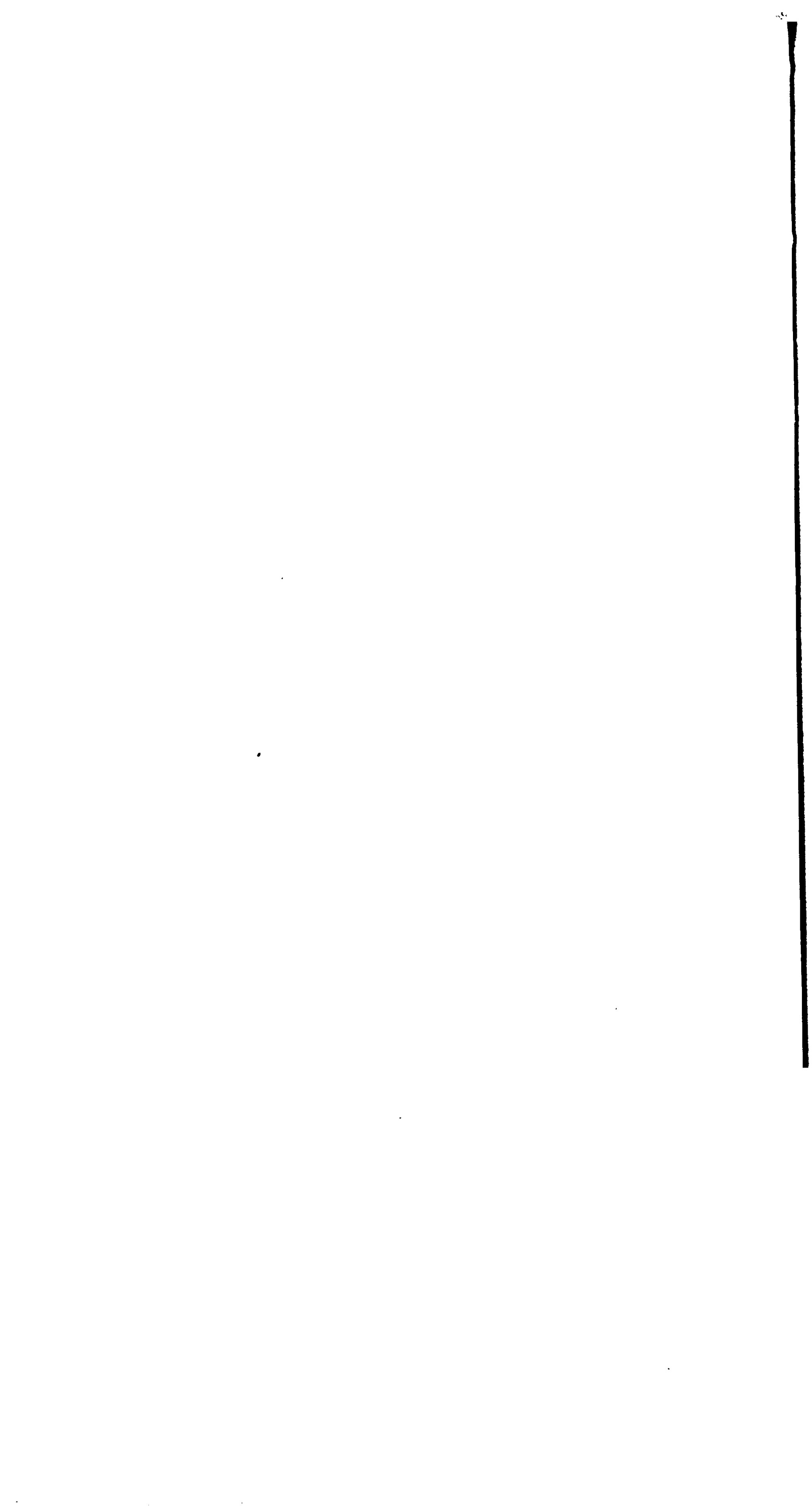


THE TAX REFORM ACT OF 1969

Summary of Testimony
of Wilbur J. Cohen
Senate Committee on Finance
September 18, 1969

1. The tax yield under the Tax Reform Bill should be increased.
2. More Federal funds are needed for education to increase economic growth and keep a dynamic economy.
3. Additional taxes should be derived from elimination of accelerated depreciation for high-income and luxury housing, tightening farm losses, capital gains, withholding of dividends and interest and decrease in the depletion allowances.
4. Dependents' deductions should be modified in the light of family planning policy.
5. Changes should be made in tax policy on health insurance premiums so as to help reduce Medicaid costs.
6. Special taxes on Foundations should be dropped and a filing fee substituted.
7. U. S. taxes are not as high as many other countries.
8. Treasury Department should issue a complete report on Tax Bill.
9. A Presidential Committee on Tax Policy should be appointed.
10. Tax credits for tuition should not be enacted.
11. Some way should be found to reduce residential property taxes.
12. Shared-revenue with the States should not be enacted until all States have State income taxes.



THE TAX REFORM ACT OF 1969

Statement by

Wilbur J. Cohen
Professor of Education
The University of Michigan

September 8, 1969
To The Senate Committee on Finance
Washington, D. C.

It is a distinct pleasure for me to come before this committee again, but in a somewhat different role than my last several appearances.

You might well wonder why a man who has appeared before you so many times for authorization of substantial expenditures should now appear on a tax bill. I do not appear as an expert on taxes although, as you know, the social security and unemployment taxes about which I had some expertise now comprise about 15 percent of the total Federal expenditures.

I appear today because I believe in deciding on the content of this tax bill, you should give consideration to its relationships to expenditures and to other facts such as inflation, employment and unemployment and incentives. Such broad general public policy considerations must be taken into account in your decision on individual proposals and the entire bill.

May I say that since leaving Washington on January 20, due to forces over which I had no control, I have had the benefit of

being supported by the University of Michigan to think and write on matters of public interest, and to have the opportunity to review public policy questions with my University Colleagues in a non-partisan manner. I appear before you today only representing myself; and it even may be that subsequently, after reviewing the evidence taken at these hearings, I may modify or repudiate some of the views I express today.

May I first say that, whatever comments and suggestions I make today, I hope my friends on the Committee on Ways and Means will not take them as a personal criticism. They labored hard and very well. They should be congratulated on the scope and daring of their achievement. But as Lord Beveridge said: "The good should not be the enemy of the better." This is a good tax reform bill, but it can and must be made better.

Adding to the Increases

There are numerous suggestions pending before your committee on how to produce a greater tax yield in this bill. I support the general outlines of the proposals by Senators Ribicoff, Hart, and Kennedy. I particularly urge you to eliminate accelerated depreciation for high-income and luxury housing, to tighten controls on deductions for farm losses, raise additional taxes from capital gains, authorize withholding of dividends and interest, and decrease the depletion allowances.

Priorities

Why do I make this request? Because our nation is faced with a grave domestic crisis. Our inner cities are rotting away. Our educational system is deteriorating in many places. Air pollution and water pollution are advancing in many places. Congestion on the highways increases. Highway deaths are scandalous. We have needless hunger and poverty for far too many of our fellow citizens. And our infant mortality rate is way too high for many groups. There are over 5 million of our aged who are living in poverty.

I must put the issue very frankly: our nation will be making a big mistake if the bill you report to the Senate reduces the total tax income of the Federal Government at this time.

You have an HEW appropriation bill pending in the Senate Appropriations Committee which reduces the amount available for training more doctors and nurses, which freezes the medical research capability of this nation, which appropriates only about one-half of the authorization for elementary and secondary education you enacted, and which limits the amount needed for pre-school education. Quite frankly, gentlemen, if you vote for HEW appropriations this year so far below the legislative authorizations and at the same time vote to decrease the total tax yield to the Federal Government, you will be voting for further rebellion and dissension not only on the campus, but in

the churches, the streets, the inner cities, and elsewhere. I urge you to consider the seriousness and importance of this tax bill to improving our domestic situation in the next year or two.

A study of a number of countries recently made by OECD shows that during the period 1955-67 the annual growth rate for public expenditures on education in the United States was 8.2 percent while the annual growth rate for the gross national product for the years 1957-66 was 4.2 percent. This meant that for each two points increase in public educational expenditures there was about a one point increase in gross national product. In Yugoslavia, where the annual growth rate for educational expenditures (1952-67) was 17.5 percent, the GNP grew 8.5 percent--more than double that of the United States.

In 12 countries (Austria, Germany, Canada, France, Greece, Italy, Japan, Netherlands, Sweden, Turkey, Switzerland, Yugoslavia) the annual growth rate of the gross national product exceeded that of the United States and in all but one (Switzerland) of these 12 countries, the annual growth rate of public expenditures on education exceeded the growth rate for the U. S.

I urge that you raise more revenue to increase our investment in education this year.

Let me point out that President Nixon's Budget for fiscal year 1970 in the Department of HEW recommends an appropriation of only about $4.6 billion out of the $11.2 billion authorized under existing legislation with specific yearly authorizations. In other words, there is a $6.6 billion gap.

Moreover, existing appropriation requests for uncontrollable items (welfare, medicaid and general revenue contributions for social security and Medicare) which total $9.3 billion for fiscal year 1970, are estimated to rise to $17.4 bi on by 1974, with no change in the legislation.

President Nixon has proposed legislative changes reducing Medicaid costs by $400 million in 1970 and by increasing welfare costs by $4 billion by 1972. The latter figure is undoubtedly understated in my opinion.

From the standpoint of inflation, now is the time that you should enact a tax reform bill which would collect much more than you reduced taxes. From this standpoint, I would suggest that this tax bill in 1970 should yield at least $2 or $3 billion more than the total reductions.

A bill which produces more reductions than increases would be grossly short-sighted. A bill which neatly balances reductions and increases may be a good political bill, but it will fail to

meet our nation's needs and could be termed an "unstatesman-like" bill. A bill which produces more revenue than reductions would be a recognition that our urgent domestic needs will be given priority.

Every 1% increase in the consumer price index will sooner or later result in an increase of Federal Government expenditures of nearly $2 billion a year. Of course, as prices rise, the tax yield will undoubtedly also be somewhat greater. But the cost of inflation will be built into salary increases, retirement pay increases, medical costs, and purchases.

Stretching Out the Reductions

May I point out how easy it was to reduce taxes in 1964 and how difficult it has been to restore them only partially in 1968 and 1969. Perhaps the reduction in 1964 was too much. Perhaps we should ask whether all the reductions in this bill are too much in too short a time. I favor all the reductions, but it may be that some should be spread over a longer period of time. Could I suggest that it might be both good economics and politics for part or some of any reductions to be effective in 1970, and to stretch the full effect of the reductions over several years, making some part of them effective the magic year of 1972 as well?

Conservation and the National Interest

I hesitate to venture into the field of depletion allow-

ances about which the Chairman of this Committee knows so much more than I do. But I must make this point. If the depletion allowance is necessary to encourage drilling in this country, why do we reduce or exhaust our domestic supplies, before using foreign supplies? Since we are rapidly running out of valuable domestic resources, why don't we reduce the depletion allowances and save more of our domestic resources for our children and grandchildren? This isn't solely a matter of tax eld above, it is a matter of conservation patriotism, long-r ge planning. The basic argument the oil companies make for ret ing the present depletion allowances persuades me to the contrary. I strongly urge you to reduce the depletion allowance to 15 percent in the final bill. To do so, the Senate, in my opinion, will have to pass a 10 percent provision in order to be able to get 15 percent in Conference.

Dependents' Benefits

The present system of allowing an equal amount for each and every dependent is neither well grounded in fact (as any parent can tell you) nor is it intelligent social policy to give a financial incentive to have more children. A more sensible policy would be $700 for the first child, $600 for the second, $500 for the third, $400 for the fourth, $300 for the fifth, $200 for the sixth, and $100 for the seventh. There was one man in one of the Government Departments who had 13 children. Why subsidize him by the tax system to have more children?

This Committee took the leadership in making family planning services available in 1967 under Title V of the Social Security Act. Why not carry out the social policy in your tax reform bill?

Withholding of Dividends and Interest

For the life of me, I can't understand why if withholding is proper for salaries, why it isn't for dividends and interest. There is no question in my mind that you may be losing some taxes by the present policy. This is a real loophole, which should be closed. I strongly urge you to include withholding of dividends and interest in this bill.

Health Insurance Premiums

Your Committee has accepted the principle that employer contributions for health insurance are deductible as a business expense. You have concurred in the practice of deducting from gross income one-half of any contributions for health insurance premiums up to $300 a year. Certain medical expenses are deductible.

You have also accepted financial responsibility under Medicaid for a large and growing expenditure, but have neglected to assure yourselves that every possible man, woman and child will be covered by health insurance instead of relying on Medicaid.

I urge you to make as a condition of any employer, corporation, or trust obtaining any tax deduction for any contribution toward a pension, profit-sharing or stock option plan or similar arrangement -- that all his employees be covered under a medical policy whose scope is at least as broad as Medicare, and that the employer pay at least one-half of the cost of the employee coverage.

Treatment of the Elderly

I urged the House Committee on Ways and Means to simplify the reporting of income and credits for the elderly. Although this part of the tax return is the most complicated part of the entire return, no action was taken.

The double exemption for the elderly plus the exemption of social security income coupled with the tax changes in the bill will relieve many lower-income elderly persons from taxation. This is to the good. But many high-income elderly persons still obtain a favorable tax advantage by virtue of these special provisions. When you are making these other changes favoring the low-income taxpayer, that is the time to make the reforms affecting the higher-income elderly.

Social Security Contributions

I endorse the low income allowance in the bill. I believe you should also consider the employee and self-employed person to claim a refund of one-half of the employee or self-employed social security contribution, if his income is below the new

level of non-taxability in the bill.

You might also consider taxing one-half of the social security benefit above a minimum, such as $125 a month.

Foundations and Charitable Deductions

The provisions of the House-passed bill relating to Foundations and Charitable contributions raise major matters of social policy. You have been hearing from many people on these provisions and you will hear much more before you complete these hearings. Because there has been adverse publicity on certain grants made by some Foundations is not ample grounds for discouraging the great work of the Foundations which have stimulated some of the great medical, scientific, literary and educational innovations.

I urge you to make any amendments to these provisions effective for only two years and to renew them independently and separately as a matter of long-range national policy.

May I also point out if the 7 1/2 percent tax on net investment income of a private Foundation is a minimum tax, then the principle should apply equally to all other charitable, as well as business, enterprises. A policy of non-discrimination should be applied.

The sanctions in the bill for a violation of the provisions

relating to Foundations is clearly punitive. To tax a Foundation 100 percent for any amount paid for a so-called improper purpose is unwise. A 50 percent penalty should be the maximum.

May I point out to the Committee if there is any logic to this provision, then the same penalty should apply to all improper expenditures of any taxpayer.

If the punitive taxation of any improper purpose is retained in the bill, then I believe expenditures for such purposes should be reported fully and publicly so there can be public review of the impact of such policy on the contribution of foundations to the national interest.

Instead of the special and punitive taxes on Foundations in the House-passed bill, I recommend substitution of filing fees.

Comparative Taxes with Other Countries

I appreciate that the American taxpayer is desirous of both tax reform and tax reduction. But the demands of a dynamic, urban, innovative society cannot be carved out without substantial taxes. The question is how much and who should bear the burden.

In 1965, total tax revenues in the United States (Federal, State, and local) were equal to 27.3 percent of the gross

national product. This was made up of 9.3 percent direct taxes on individuals and families, 4.5 percent on corporations, 9.3 percent in indirect taxes (including real estate taxes) and 4.2 percent in social security taxes.

Table 1 shows 12 countries which were paying more than the United States in taxes in relationship to GNP, and 12 countries which were paying less. Note that in the list of those paying more than the U. S. are industrial countries which are in the forefront of industrial development. Among the 12 countries paying less than the U. S., one finds only Australia, Japan and Switzerland; the remainder are smaller, less affluent nations.

Of course, if you ask any individual if he would like his taxes reduced, the answer is going to be close to 100 percent. The truly civilized man would answer -- what are the alternatives and consequences of such action?

The fact is that among the industrial, affluent, and incentive economies of the world, we are not paying the highest taxes. This is not an argument for higher taxes, or to retain existing taxes. It is simply a fact that the overall burden of taxes in the U. S. is less than many other countries.

TABLE 1

TAX REVENUES IN RELATION TO
GROSS NATIONAL PRODUCT, 1965, BY COUNTRY

Countries in Which the Tax Revenue as a Percentage of GNP in Relation to the United States is:

	More			Less	
1.	Austria	35.1	1.	Australia	24.1
2.	Belgium	29.7	2.	Bolivia	12.8
3.	Canada	31.0	3.	Chile	23.7
4.	Denmark	29.7	4.	Columbia	11.8
5.	Finland	29.4	5.	Greece	20.8
6.	France	38.5	6.	Ireland	24.8
7.	Germany	34.3	7.	Japan	19.8
8.	Italy	29.7	8.	Korea	9.0
9.	Netherlands	34.1	9.	New Zealand	26.3
10.	Norway	34.9	10.	Portugal	19.0
11.	Sweden	39.0	11.	South Africa	16.9
12.	United Kingdom	30.3	12.	Switzerland	20.9

SOURCE: Facts and Figures on Government Finance, 1969, Tax Foundation, page 32.

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TABLE 2

TAX REVENUES IN RELATION TO

GROSS NATIONAL PRODUCT, 1965, BY MAJOR TAX CATEGORIES

	Total Taxes	Direct Taxes On Individuals	Direct Taxes On Corporations	Social Security	Indirect Taxes
United States	27.3	9.3	4.5	4.2	9.3
Belgium	29.7	7.0	1.9	8.6	12.2
Canada	31.0	7.4	4.8	2.1	16.7
Germany	34.3	7.9	2.5	9.8	14.2
United Kingdom	30.3	9.3	2.1	4.8	14.1
Sweden	39.0	17.7	2.3	6.2	12.8
Japan	19.8	4.4	4.0	3.5	8.0

SOURCE: See Table 1

Further Review

Mr. Chairman, the economic and social implications of this tax bill are so substantial and so far-reaching it would be foolhardy to think that the final bill will be a model of perfection or unanimity of agreement among all affected. The Surrey tax study was a monumental achievement and Stan Surrey should be given the Treasury Award of Merit for what he and his associates produced.

I suggest you write into the tax bill two provisions:

1. That the Treasury Department issue a comprehensive report within two years after the enactment of the bill which provides the Congress and the American people with all the necessary information on the implementation of this act. The Freedom of Information Act should apply to the tax bill.

2. A Presidential Commission of 12 distinguished citizens should be appointed to review the law and its application and make recommendations to the President and the Congress for any changes. Such a Report should be published on December 1, 1972.

I think such studies should include some way to reduce local residential property taxes as a method of financing elementary and secondary schools. I, for one, am opposed to the President's shared-revenue proposal as long as 1) there are States which do not have a State income tax, and 2) such a proposal does not assure that there will be some reduction in property taxes, and 3) that a substantial

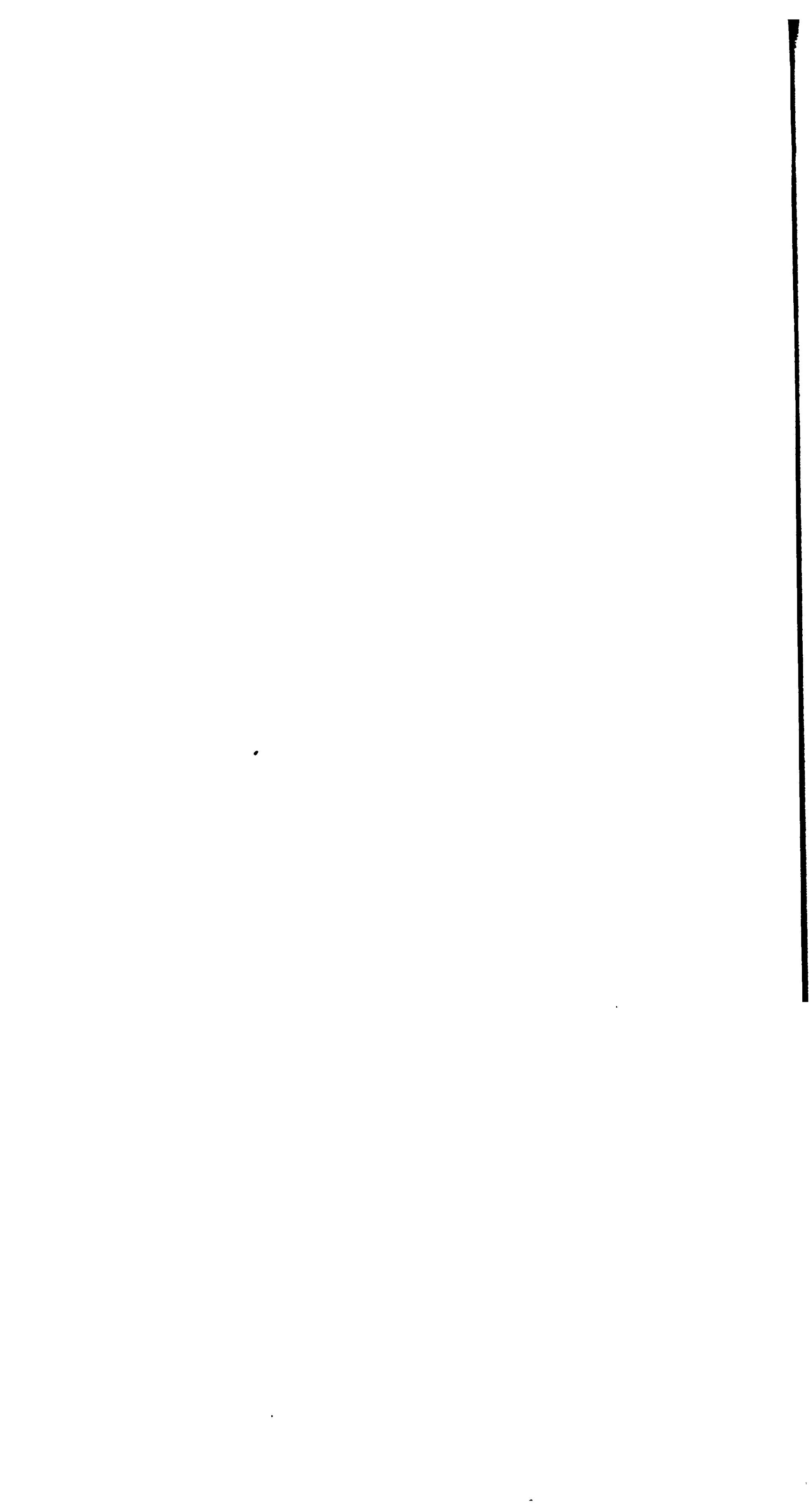
portion of the money will be used for education, and 4) Congress has not appropriated the full amounts authorized under existing education legislation.

I believe the House Committee on Ways and Means, the Senate Committee on Finance, and the Joint Committee on Internal Revenue Taxation should take jurisdiction of the shared-revenue proposal and consider it together with the proposals for overhaul of our welfare system, the tax system, and the improvement of the social security, medicare and medicaid program.

In this connection, I must make clear that I do not support the proposal pending before your Committee for a tax credit for tuition fees for higher education. While there is substantial support for this from the higher income earners, it is wrong in principle and in practice, and would not be helpful to higher education. My criticisms against this kind of proposal are on record while I was an official of the Department of HEW under three Secretaries.

I reaffirm my opposition as a citizen and as a Dean of a University School of Education.

PART B—ADDITIONAL STATEMENTS



TESTIMONY

SENATE FINANCE COMMITTEE

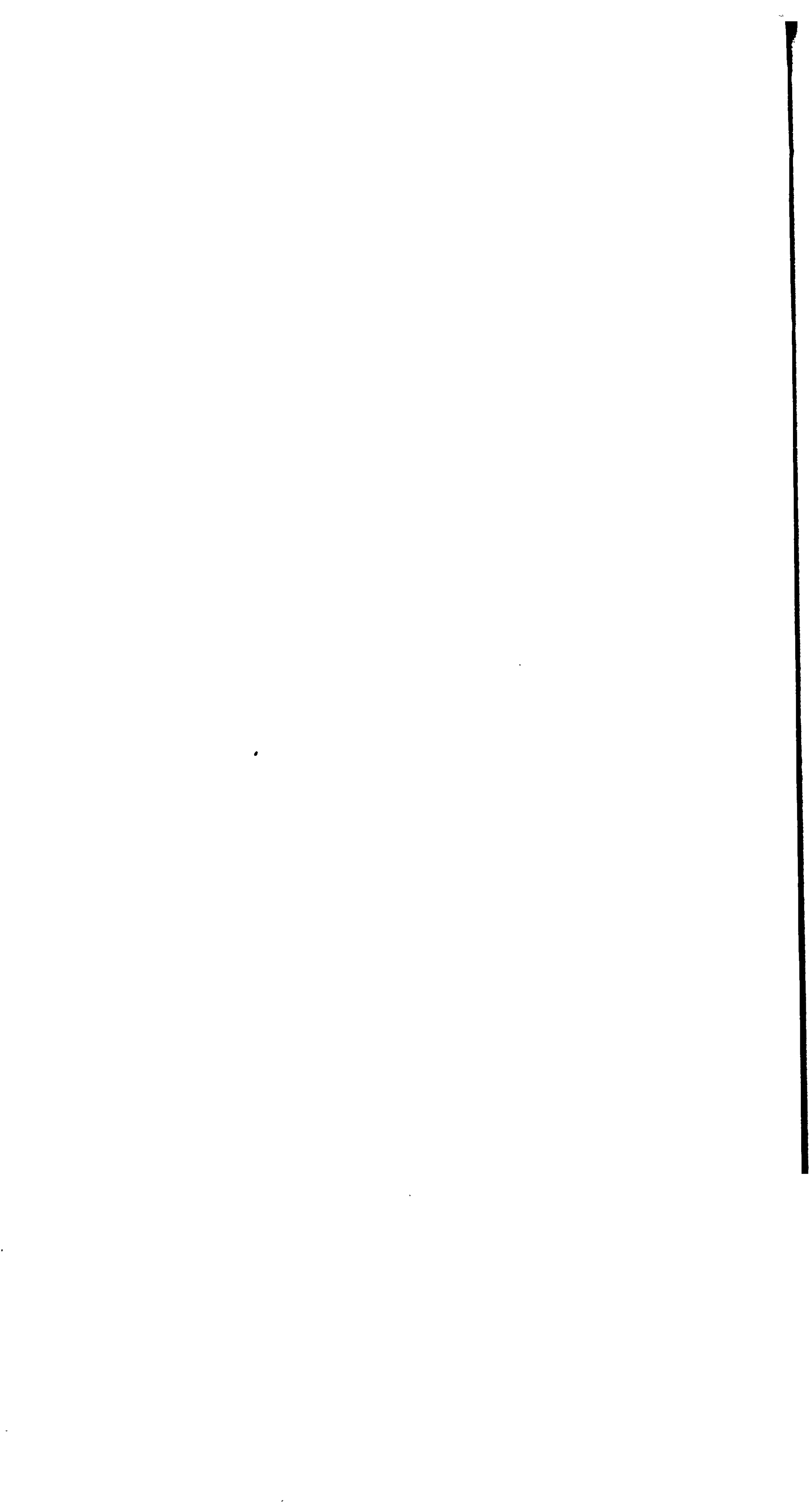
prepared by Rodney L. Houts

representing

WASHINGTON FRIENDS OF HIGHER EDUCATION

(an organization representing the presidents and boards of trustees of all but one of the independent accredited colleges of the state of Washington)

September 15, 1969



TESTIMONY - SENATE FINANCE COMMITTEE

HIGHER EDUCATION IN THE STATE OF WASHINGTON

The Washington Friends of Higher Education represent all but one of the independent accredited colleges in the state of Washington. This organization has been authorized to speak for the colleges by the presidents and trustees of nine institutions of higher learning. These are, as follows: Gonzaga University, Pacific Lutheran University, Fort Wright College of the Holy Names, St. Martin's College, Seattle Pacific College, Seattle University, University of Puget Sound, Walla Walla College, and Whitworth College. The average age of these institutions is more than 88 years. They represent more than 64,000 living graduates--and presently have enrolled approximately 19,000 students. The annual operating budgets of these institutions exceeds $38 million annually.

During their last fiscal year, these institutions received in gifts more than $7.5 million, of which more than $3 million was in the form of appreciated property. During the last five years, these schools have received more than $44 million in gifts, of which some $17 million dollars was in the form of appreciated property.

These institutions have received in the form of trusts, annuities, and other types of deferred, irrevocable gifts in excess of $10 million in the last five years. Nearly $7.5 million of these gifts came in the form of appreciated property. In addition, these institutions are now holding deferred gifts subject to life estate, some from $14 million worth of expectancies.

It is evident from the foregoing figures that gifts--both outright and deferred, and particularly those that come in the form of appreciated property--are absolutely essential to the continuation and the growth of the private sector of higher education in the state of Washington. A sector which incidentally provides a substantial number of the graduates placed into the working economy of the state annually. We therefore urge your careful attention to our testimony which has a direct bearing on our ability to help ourselves.

PARTNERS IN A CAUSE

We, the Washington Friends of Higher Education, believe that our institutions are playing a vital role in preparing young men and women for the leadership of the nation. Our graduates are found in many walks of life--in business, the professions, politics, education, and in social service. We feel, therefore, that we are partners with the Government and Governmental leaders in a cause which is directed toward the highest national good.

For this reason we want it clearly understood that we are in favor of tax reform, that we are in sympathy with Congressional leaders who are seeking equitable and just tax legislation. We would be the first to encourage Congress to eliminate those places in our tax law where individuals are able to use the law for their own selfish means in a way not intended by Congress. We therefore support the underlying principles which created House Bill 13270--and much of what is contained in that Bill.

We are, however, desperately concerned about a few items in House Bill 13270 which would seriously affect our ability to encourage increased support of our institutions. We are totally dependent upon such gifts. Some

of the things contained in this Bill would have a devastating effect on those gifts.

HOUSE OF REPRESENTATIVES BILL 13270

The items contained in House Bill 13270 which gravely concern the colleges and universities of the state of Washington are as follows:

1. THE INCLUSION OF GIFTS OF APPRECIATION OF PROPERTY IN THE LIMIT ON TAX PREFERENCES AND THE ALLOCATION OF DEDUCTIONS

   We are pleased that the House Bill retains the present law that a deduction is allowed for the full present fair-market value of a gift and that there is no direct capital gain on the appreciation. However, if a gift of appreciated property is included in the limit on tax preferences and the allocation of deductions, the appreciation will be indirectly or partially taxed because the appreciation on the charitable gift reduces the donor's itemized deductions under the allocation of deductions provision, and may be taxed under the limit on tax preference provision. We are pleased that the Nixon administration has recommended that this provision in HR 13270 be changed; and we urge you to accept that recommendation. Under the House provision for the allocation of deductions, the donor who contributes the appreciation on property would have to reduce not only his charitable deduction but also his other deductions for taxes, interest, medical expenses, etc. This is an indirect way of taxing the appreciation and would discourage gifts of appreciated property which are so vital to our institutions. By including the appreciation on property contributed to a charity in the limit on tax preferences, large individual gifts of appreciated property would be discouraged. These large individual gifts are also very much needed and have long been encouraged by Congress.

2. CHARITABLE REMAINDER (LIFE INCOME) TRUSTS [BILL SECTION 201 (i), p. 135, line 3]

   Present law providing for the charitable deduction allowed for the type of charitable remainder currently used should be retained. Present law provides that there is no capital gain on the transfer of appreciated property to fund a charitable remainder or life income trust, nor is there a capital gain if the property transferred is later sold by the trust and the gain permanently set aside for the charity. These rules should be retained. The very complicated provisions for a charitable remainder annuity trust and a charitable remainder unitrust should not be substituted for the now widely used and understood charitable remainder trust. These latter trust agreements are too complicated to be understood by donors and would greatly hinder our ability to raise these types of funds. These types of gifts are

becoming an increasing part of our gift income. Abuses of the investment policies or other handling of these trusts are very rare, and the Internal Revenue Service has ample means available to curb any abuses which might exist. We urge you not to destroy this important part of our gift income.

However, should Congress decide to abolish the existing charitable remainder trust and substitute the annuity trust and unitrust, the laws governing the present remainder trust should not be retroactive to April 22, as provided by House Bill 13270. This is totally unfair to our donors who have established such trusts since April 22, unaware that such a law would be passed--and without prior warning. Such irrevocable gifts are presently in effect in our institutions.

In addition, whether the present remainder trust remains in effect, or whether the new unitrust or annuity trust is established, the charitable deduction for gifts of appreciated property should be based on the fair market value of the trust at the time of its creation. The donor should not be required to base his deduction upon his cost basis or pay a capital gain if he elects to compute his deduction based on the fair market value.

Furthermore, capital gains incurred by the trust--and permanently set aside for the charity--should not be taxed. We do not believe that a donor should be taxed on money which he can never, and will never, receive since it is laid aside for the permanent use of charity.

Finally, the House bill allows no estate tax charitable deduction for a charitable remainder trust unless it is a unitrust or annuity trust. It is our understanding that this law would apply to charitable remainder trusts created before the bill's enactment. Therefore, one of our donors who may have created such an irrevocable trust many years ago, but who dies after the bill's enactment, would lose his estate tax charitable deduction unless that charitable remainder trust were a unitrust or an annity trust. This provision in the House bill is unusually harsh and unfair. We can only assume that it must be an oversight. This retroactive change would require that substantial estate taxes would have to be paid, which would come usually not out of the trust's principal but from other assets of the estate thereby reducing or in some cases even eliminating bequests to the donor's wife, children, and other family members. We urge you not to apply an estate tax to the trust principal of a charitable remainder trust. However, if such a provision is to be passed, it should not apply to charitable remainder trusts and life income contracts made prior to the passage of the bill.

3. LIFE INCOME CONTRACTS

We urge that present law governing life income contracts be retained. Presently there is no capital gain on the transfers of appreciated property for a life income contract, nor is there capital gain when the property transferred is later sold by the life income pooled fund. As is the case with the charitable remainder trust, we believe that the deduction should be based on the full fair-market value without

capital gains tax--and that no further capital gains tax should be incurred by the life income pooled fund, which is permanently set aside for charity.

However, if this important form of gift income should be denied us, such laws should not be retroactive to April 22, 1969, as provided by HR 13270. There was no indication by either the House Ways and Means Committee or the Nixon administration that a retroactive date would be in effect for these contracts. This is, therefore, especially unfair to donors who have provided for these kinds of contracts after that date.

4. CHARITABLE GIFT ANNUITIES

The provisions concerning bargain sales, provided for in House Bill 13270 and enacted, should specifically state that the transfer of appreciated property for a charitable gift annuity is not a bargain sale. Under the present House bill, the transfer of appreciated property for a gift annuity could be construed as a bargain sale, the donor receiving an annuity rather than cash from the charitable institution. This long established form of giving should not be abolished. Most of our colleges hold a substantial amount of funds subject to gift annuity agreements. We believe that the failure to except gift annuities from the provision governing bargain sales must have been an oversight by the House Ways and Means Committee. We urge you to provide for that oversight.

5. ABOLISHING OF THE INCOME TAX CHARITABLE DEDUCTION FOR GIFTS OF PARTIAL INTEREST IN PROPERTY [Section 201 (a) (3), p. 121, line 8]

We assume that this portion of the House Bill is intended to deny a charitable deduction to a donor for the fair rental value of property which the donor allows a charity to use rent free. However, the language of this section of the bill has us concerned, inasmuch as it could be interpreted to abolish a deduction for gifts of undivided interest in real property as well as for gifts of remainder interest in real property. If the Senate wishes to deny a deduction for the use of property, we would urge you to rewrite the House provision so that it does not include gifts of real property subject to life estates and gifts of undivided interest in real property.

IN SUPPORT OF HR 13270

We support and commend Congress for many of the provisions in House Bill 13270. Some of these also affect charitable giving. Three items in particular come to our attention:

1. We support you in eliminating Clay Brown transactions. We believe organizations should be taxed on income received from debt-financed investments.

2. We believe that organizations now exempt from tax should be taxed on unrelated business income.

3. We applaud Congress on its attempt to encourage charitable giving, to organizations serving the national good, by increasing the ceiling on gift deductions to 50 percent.

CONCLUSION

The colleges and universities of the state of Washington are dependent upon gifts for their support and continued growth. A substantial portion of these gifts come in the form of appreciated property. An increasing amount comes in the form of deferred giving programs, which include charitable remainder trusts, life income contracts, and gift annuities. If the House Bill is passed, these gifts to our institutions will be greatly reduced. At a time when Congress is seeking ways to assist higher education in meeting heavy financial needs, it is inconceivable to us that tax law should be passed which would make it impossible for us to help ourselves. Now is the time to increase tax incentives, not decrease them. Congress has continually, over a long period of time, liberalized tax law to encourage gifts to our institutions. And each time Congress has indicated that any tax revenues lost were more than made up for by the good which these charities provided in the national interest. We urge you not to reverse that magnificent record.

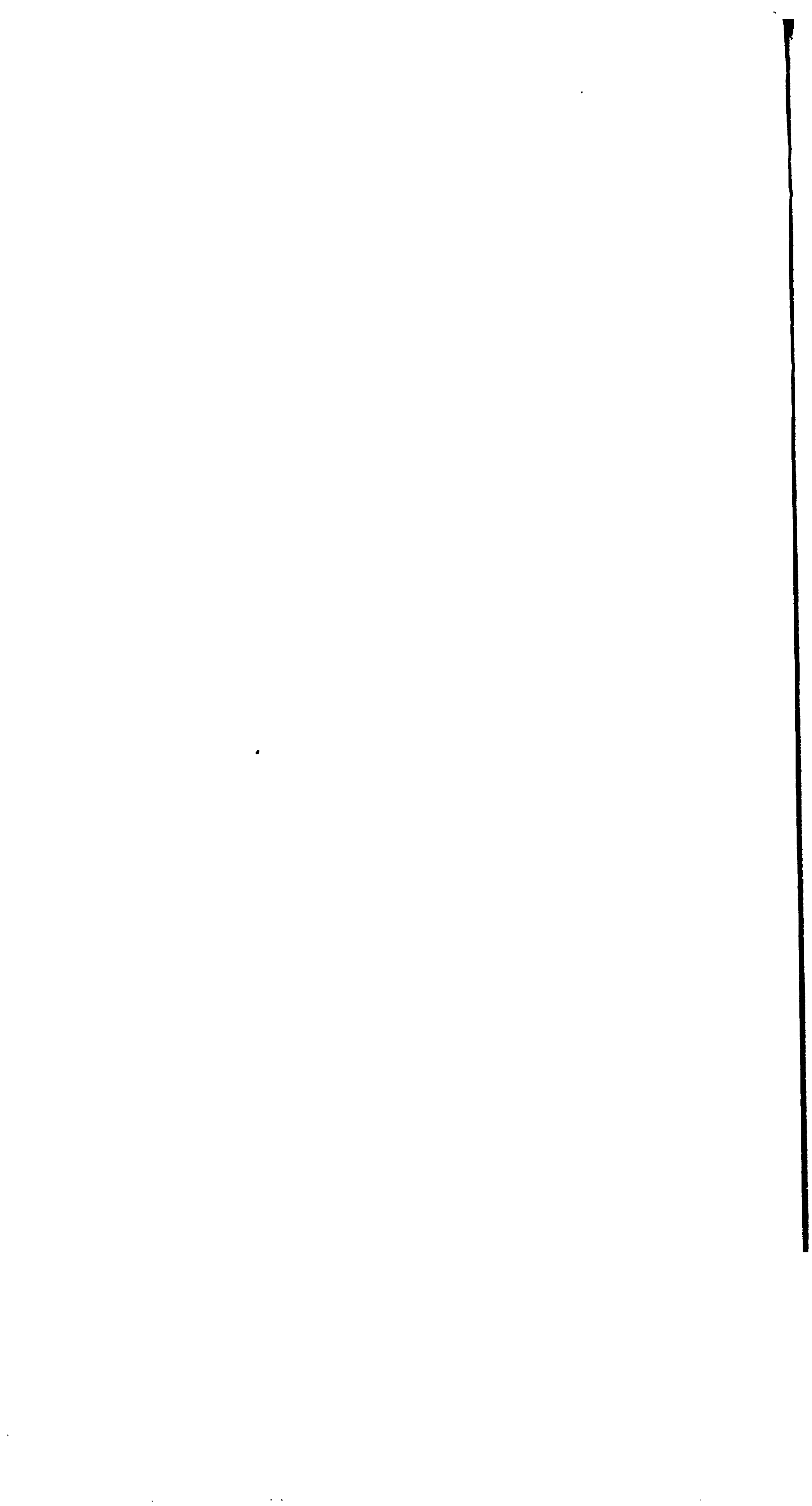
The Independent Colleges of Washington are making a substantial con-contribution in preparing leadership for our nation. Were they to cease to exist, the burden of educating these young people would have to be carried by our state institutions, at the cost of an enormously increased tax burden for our citizenry.

A charitable deduction should not be thought of in the same terms as

are other deductions. The philanthropically-minded person does not give up his money and property for personal gain, but rather to help our institutions to provide for others--and for the good of the nation. Although he is not motivated solely by tax advantages, these tax advantages do assist by making it easy to give and by allowing him to give larger amounts than might otherwise be possible.

Provisions in the House Bill which have to do with charitable giving, both directly and indirectly, are extremely complicated. Our institutions have succeeded in increasing their gift support by making it easy for the donor to give. The very complex nature of the House Bill will tend to discourage our donors from giving.

Again, we wish to support Congress in its desire to reform tax law. We urge you, however, to protect those long established tax incentives which have enabled America's charities, colleges, and universities to show compassion and concern, to educate, to teach and build--and indeed to share with you, and with all America, the task of building a better and a greater America.



TEL 246 3200 THE UNIVERSITY OF SANTA CLARA • CALIFORNIA • 95053

12 September 1969

The Honorable Russell B. Long
Chairman
Senate Committee on Finance
2227 New Senate Office Building
Washington, D. C.

Dear Senator Long:

I had asked and hoped to appear to testify in person but I fully understand why the list of witnesses had to be pared to a reasonable number. I shall be brief in what I have to say about HR 13270.

We fully understand the need for substantial tax reform - the need for a better measure of equity in assessment of taxes by the Federal Government. Now, however, not only the University of Santa Clara but also all of higher education and, indeed, all of philanthropy, are faced with a hastily passed Bill, the provisions of which, in my opinion, do violence to the philosophical principles that have guided and guarded our traditional American principles of self help and self reliance in solving our own problems.

Since its founding in 1851, 17,500 men and women have obtained their academic or professional education and training in 23 fields of study at the University of Santa Clara. No tax dollars had any part in enabling them to do so. Most of the cost was borne in the traditional American way of self help - tuition, payments by students, contributions of teaching by the religious who served practically without compensation, and finally, and most important, by the gifts of unselfish individuals who wished to serve the cause of higher education and, in so doing, are not unmindful that Congress has always by its declarations and its enactments affirmatively provided an incentive for philanthropic giving to the end that privately supported higher education might flourish in this country.

We applaud warmly some of the Bill's provisions that seek to abolish abuses and eliminate inequities, even though some of them would result in some diminution of gift support. Any provision of the law or

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supporting regulations which are susceptible of abuse should, of course, be eliminated.

Unfortunately, this too hastily passed piece of legislation includes strictures that would inhibit the incentives for philanthropic contributions which until now the Congress has always affirmatively encouraged.

Our principal objections relate to the suggested treatment of gifts of property, specifically, in our opinion, the inclusion of philanthropic gifts in the other items categorized in the provisions for Limited Tax Preferences and subsequently in the Allocation Of Deductions. The deductibility of charitable gifts which benefit society as a whole is not of the same nature and is not to be compared with the other items in the LTP category, which are solely a benefit-detriment by-play between the tax payer and the Treasury. True, the philanthropic donor does derive some tax benefit from his gift and the Treasury suffers some loss of revenue because of it, but the giver's net worth is lessened and society's welfare heightened.

The provisions relating to the charitable remainder trust which eliminate the advantages of the normally heretofore approved deduction for the gift and the charitable remainder will cause incalculable damage to higher education. The fact is that many, if not most, who are philanthropically inclined will refrain from making such contributions. The result will be that appreciated property will be retained and there will neither be a benefit to the Treasury by way of capital gains tax, nor will the college be able to inaugurate programs knowing full well that they can be some day financed by the dollars they have in hand.

A final objection relates to the retroactivity promulgated when it was announced in August that April 22 was the effective date for charitable remainder trusts, life income contracts, gift annuities, short term trusts and bargain sales. Neither the University nor the donor, both of whom acted in good faith in entering into some of these transactions, knew until early August that the tax result of the gift might some day, if the Bill were to be passed in its present form, be altered.

Taken as a whole, the net effect of the Bill is to stop the flow of major philanthropic giving, and if some of the restrictive provisions I have referred to are enacted into law it will only mean that privately supported institutions like the University of Santa Clara will shrink in their scope and quality, and that higher education will then need more tax dollars to serve the nation as it must.

I appreciate the opportunity to present these views to you in writing

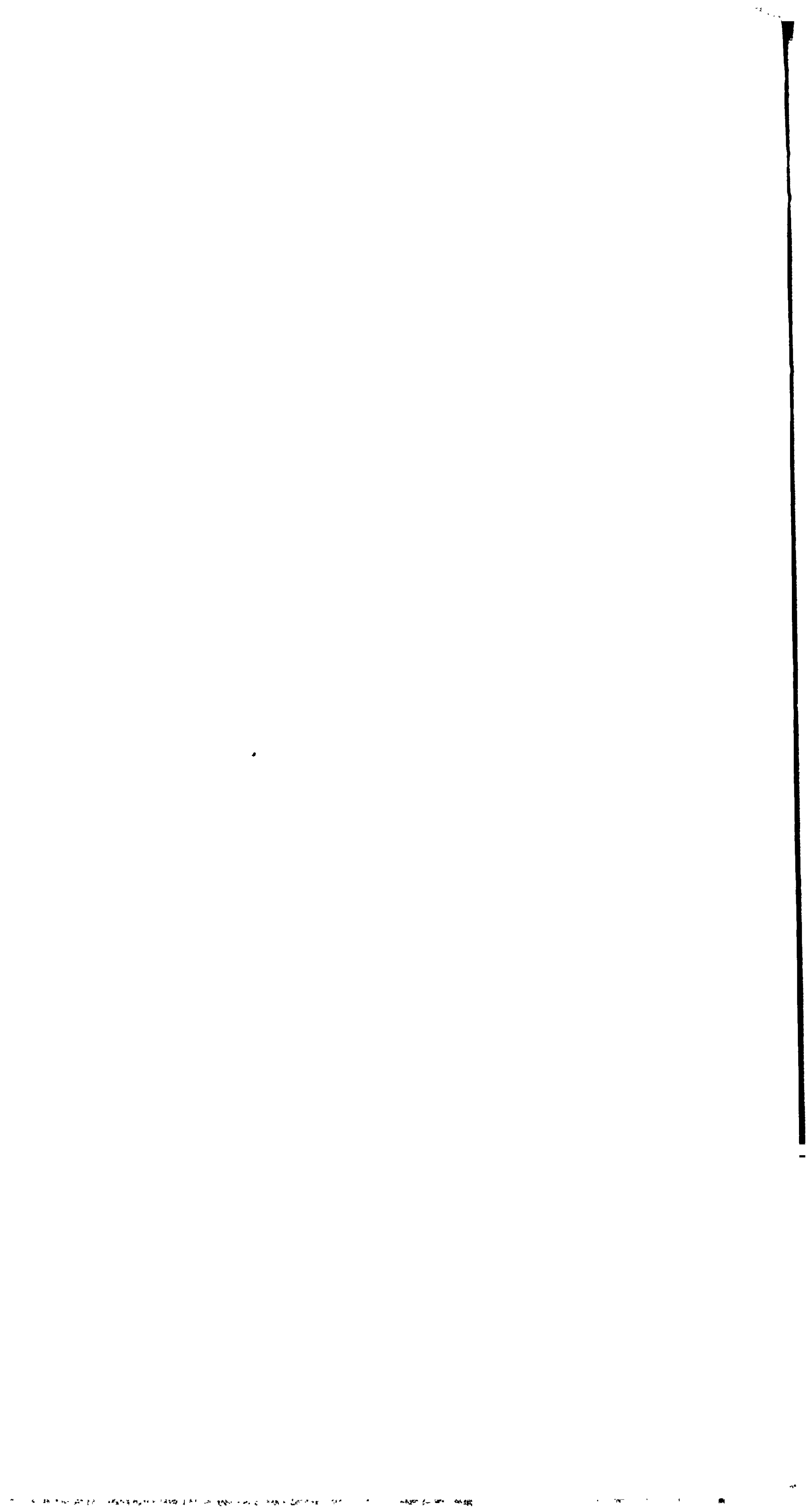
because I am convinced that this law as it now stands is the greatest legislative threat which has ever faced private higher education in the United States.

Sincerely yours,

Thomas D. Terry S.J.

Thomas D. Terry, S.J.
President

TDT:ks



SMITHSONIAN INSTITUTION
Washington, D.C. 20560
U.S.A.

Honorable Russell B. Long
Chairman
Committee on Finance
United States Senate
Washington, D. C. 20510

Dear Senator Long:

Many of the provisions of H. R. 13270, now being considered by the Senate Committee on Finance, may have a substantial effect on the activities and resources of the Smithsonian Institution. The attached statement contains comments on a few of these sections of the bill and recommendations which may be summarized as follows:

1) that the provisions of section 201(c) of the bill not be extended to tangible personal property;

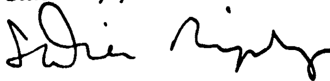
2) that museums, as a class, be included with the other educational institutions, contributions to which qualify for the extra thirty percent deduction under section 170(b)(1)(B) as amended in the bill;

3) that charitable contributions of appreciated property be deleted from the new Limit on Tax Preference and Allocation of Deductions provisions of the bill; and

4) that the provisions of the bill relating to private foundations be carefully reviewed as a whole, and specifically in order to clarify the rules on annual distribution of income and excess business holdings and to remove the punitive elements from the tax on private foundation investment income and from the treatment of donations of appreciated property to private foundations.

It would be greatly appreciated if this statement could be made part of the hearing record, for consideration by your Committee in its deliberations on this bill.

Sincerely yours,



S. Dillon Ripley
Secretary

Statement of
S. Dillon Ripley, Secretary of the Smithsonian Institution,
Presented to the Committee on Finance, United States Senate,
September 1969

on

H. R. 13270,
The Tax Reform Act of 1969

The Smithsonian, one of the oldest foundations in the United States, was chartered by the Congress to administer a private bequest for public purposes; it is a characteristic part of that remarkable partnership of private philanthropy and Government which sustains the welfare of the Nation and which H. R. 13270 may radically affect. The major purpose of those portions of the bill which deal with charity is to strengthen this partnership. Our concern is with those few provisions which seem likely to discourage the private contribution, thereby adding to the burdens of Government or perhaps crippling those activities which Government is unable or unwilling to undertake.

1. Donations of Tangible Personal Property

The Smithsonian's national collections, a priceless record of our natural and cultural history, owe their existence to more than a century of private gifts of tangible personal property. No amount of public funds could replace the treasures which the Smithsonian and the Nation's museums have received from individual citizens. On the other hand, tax incentives have played a major role in transferring objects of museum quality and national significance from private hands to museums accessible to the public.

H. R. 13270 would drastically reduce these incentives by limiting a donor's deduction to the cost of the object or, in the alternative, requiring him to include in taxable income any appreciation in the value of the object. This provision is inconsistent with the rule for gifts of appreciated securities. It will seriously affect the efforts of all our museums to preserve our cultural heritage, without perceptibly increasing tax revenues. We concur, therefore, in the Treasury's recommendation that the provisions of section 201(c) of the bill not be extended to tangible personal property.

In recent years with the inflation of art prices generally, a few donors may have claimed, in their tax returns, exaggerated values for works of art. With the cooperation of the Association of Art Museum Directors, an independent advisory group was created by the Internal Revenue Service, and the problems of valuation have been substantially reduced, without impairing the continuing benefits to the Nation from the innumerable donations made in good faith. In our view, it is in the national interest that such donations should continue to be encouraged by the revenue laws. The retention of the limitation of deductions for appreciated property to thirty percent of gross income, and the phasing out of the unlimited charitable deduction, will insure that no one will escape taxation completely through such donations.

2. Museums as Public Educational Organizations

A great many privately operated museums, although recognized for their outstanding cultural and educational contributions to society, are nevertheless seriously disadvantaged by being ineligible for the additional

ten percent deduction which is permitted for donations to other educational institutions. H. R. 13270 may make this disadvantage overwhelming for these museums since it increases the ten percent difference to thirty percent. We strongly support the proposal made by Rep. Brademas during the debate on this bill in the House of Representatives: the only adequate solution is to accord museums as a class the same recognition for public service as is given by the tax laws to colleges and hospitals. This should be accomplished by adding another category to section 170(b)(1)(B) as amended in this bill:

> ". . . (vii) a museum, defined as an organized and permanent nonprofit institution, essentially educational or aesthetic in purpose, with professional staff, which owns or utilizes tangible objects, cares for them, and exhibits them to the public on some regular schedule, "

This definition is taken from the "Interim Report from the Committee on Accreditation for the American Association of Museums" issued May 26, 1969. It is more specific than that used for other educational organizations. Perhaps it would be sufficient to add just

> ". . . (vii) a museum"

to the bill and leave the definition to the report and the regulations. In any event, the use of even the vaguest formula would be preferable to continuing and enlarging this critical inequity which threatens serious injury to the museum profession as a whole. Such action would be especially timely now, since municipal support for museums is diminishing, or is seriously

threatened, particularly in cities which are presently burdened with increased social disturbances.

3. Charitable Contributions of Appreciated Property

Contributions of appreciated property, securities in particular, have for years been the backbone of private philanthropy of all sorts. H. R. 13270 would include all such contributions, along with such items as tax-exempt interest, in the new Limit of Tax Preferences and Allocation of Deductions provisions, in effect treating such property as if it had been sold and the appreciation in value as income to the donor. However, unless appreciated property is in fact sold, it does not create "economic income" like tax-exempt interest. The result of these provisions may be to defeat such gifts in whole or in part. Where the donor would be required to expend additional funds to cover the effects of these provisions, he may be unwilling to make the gift to charity and would either retain the property or sell it for his own account. If he should sell the securities he would have given and donate the proceeds, the gift to charity is reduced by the capital gains tax. If he should sell land or a work of art, the gift of any such unique property is completely defeated.

These new provisions are so complex that no one can be certain of their ultimate cost to taxpayers, to the Government, or to charity. In the case of charitable contributions of appreciated property the rules appear to be circular: the amount of the deduction is thirty percent of gross income plus tax preferences, while the amount of the preference is based on the

amount of the deduction. One thing is certain: that these uncertainties will seriously impede the flow of funds to every major charitable enterprise on which the welfare of our society now so heavily depends. For these reasons, we strongly support the Treasury's recommendation that gifts of appreciated property to charity be deleted from the Limit on Tax Preference and Allocation of Deductions provisions of the bill.

4. Private Foundations

The Smithsonian is no longer a "private foundation," but has for years relied on very substantial gifts and grants from such organizations for many innovations in "the increase and diffusion of knowledge" for which public funds were not available. In general, these private institutions have demonstrated their value to the Nation by providing the venture capital for the basic research and social creativity which are beyond the immediate concerns of industry and Government. Many of the new sections in H. R. 13270 are designed to correct those few instances in which the public privileges of foundations have been used for private advantage. There is some danger, however, that the cure will kill the patient. Undoubtedly the whole complex of interrelated provisions should be reviewed and clarified to insure that the administration of private charity for public purposes will actually be improved and strengthened and will not be uselessly penalized for the errors of a small minority. A few specific examples and suggestions are as follows:

(a) The proposed 7-1/2 percent tax on the investment income of

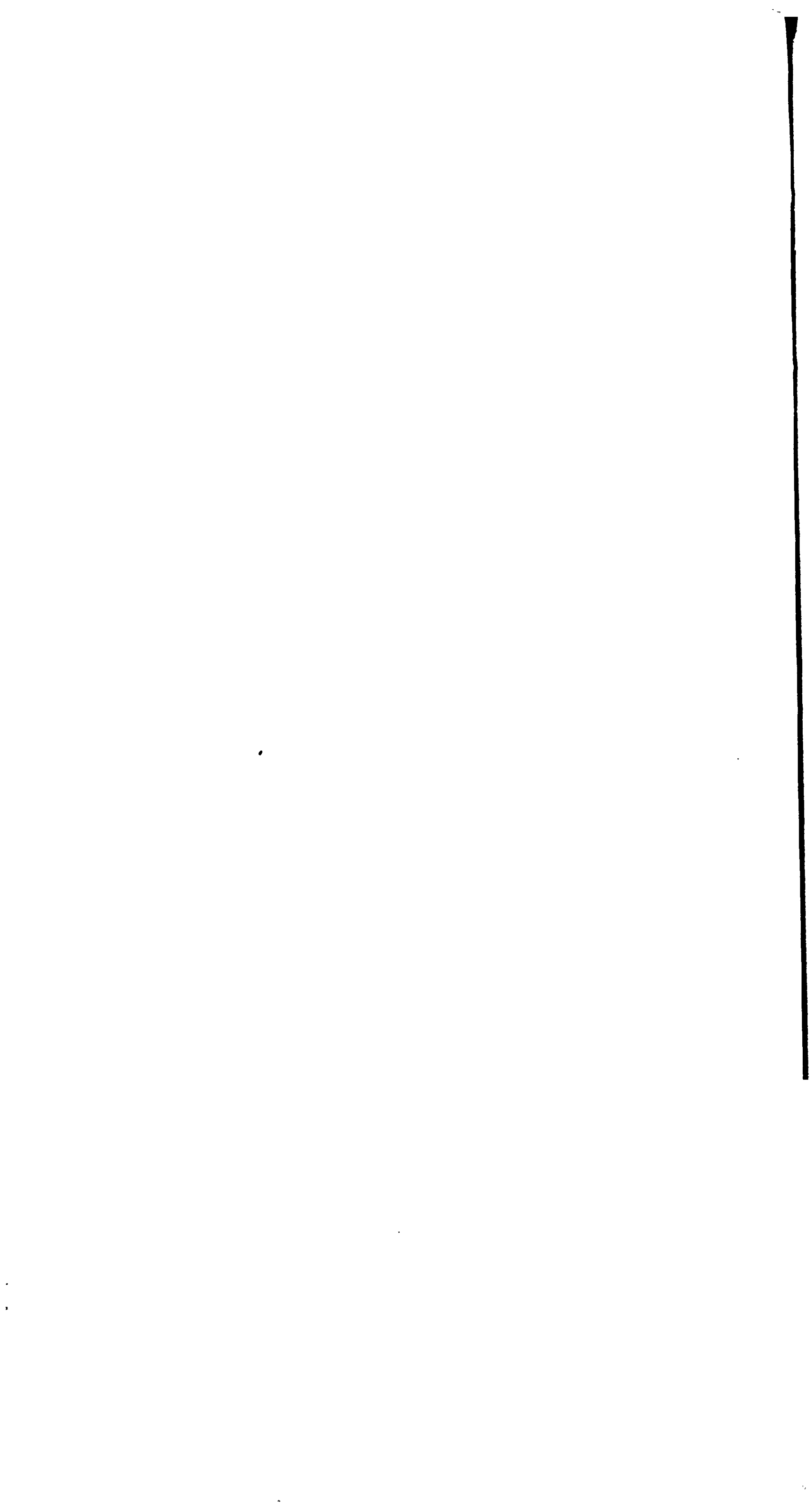
private foundations would appear to be punitive in intent, since it is in direct conflict with the principles on which tax exemption is granted in the first place. We support the Treasury's proposal to substitute a 2 percent fee solely to cover the estimated administrative cost of supervising private charity.

(b) The provisions requiring the distribution of income annually should be amended or clarified so that the income to be distributed is net income after deduction of all reasonable expenses such as the 2 percent fee referred to above. If a foundation is required each year to expend or distribute its corpus, its ultimate destruction is inevitable.

(c) The proposed rules on excess business holdings are rather inflexible. There are a variety of legal methods to accomplish the major purpose of separating control of a business from ownership of an interest therein. The "35 percent rule" should be amended to permit the Treasury, by regulation or otherwise, to accept any effective device, without setting specific and somewhat arbitrary limits on holdings of any particular class of stock.

(d) In the event that a workable system of supervision and restraint can be devised in this legislation to insure that the funds of private foundations will be used solely for charitable purposes of recognized benefit to society, it would then seem irrational and discriminatory to single out contributions of appreciated property to these organizations for treatment as sales subject to the capital gains tax. The inclusion of such gifts by

H. R. 13270 in section 170(e) appears to be based on the unstated and untenable premise that the activities of private foundations are collectively less worthy than those of other charitable organizations.



THE EFFECTS OF ORGANIZED PRIVATE PHILANTHROPY UPON EDUCATIONAL PROJECTS, PROGRAMS, INSTITUTIONS AND SYSTEMS IN CUYAHOGA COUNTY, OHIO, WHICH INCLUDES THE CITY OF CLEVELAND AND ITS CONTIGUOUS SUBURBS

PREPARED FOR KENT H. SMITH,
GATES MILLS, OHIO

NO PART OF THE COST OF THIS REPORT WAS BORNE BY TAX-EXEMPT OR TAX-DEDUCTIBLE MONEY OF ANY SORT.

Joanne Kaufman, President

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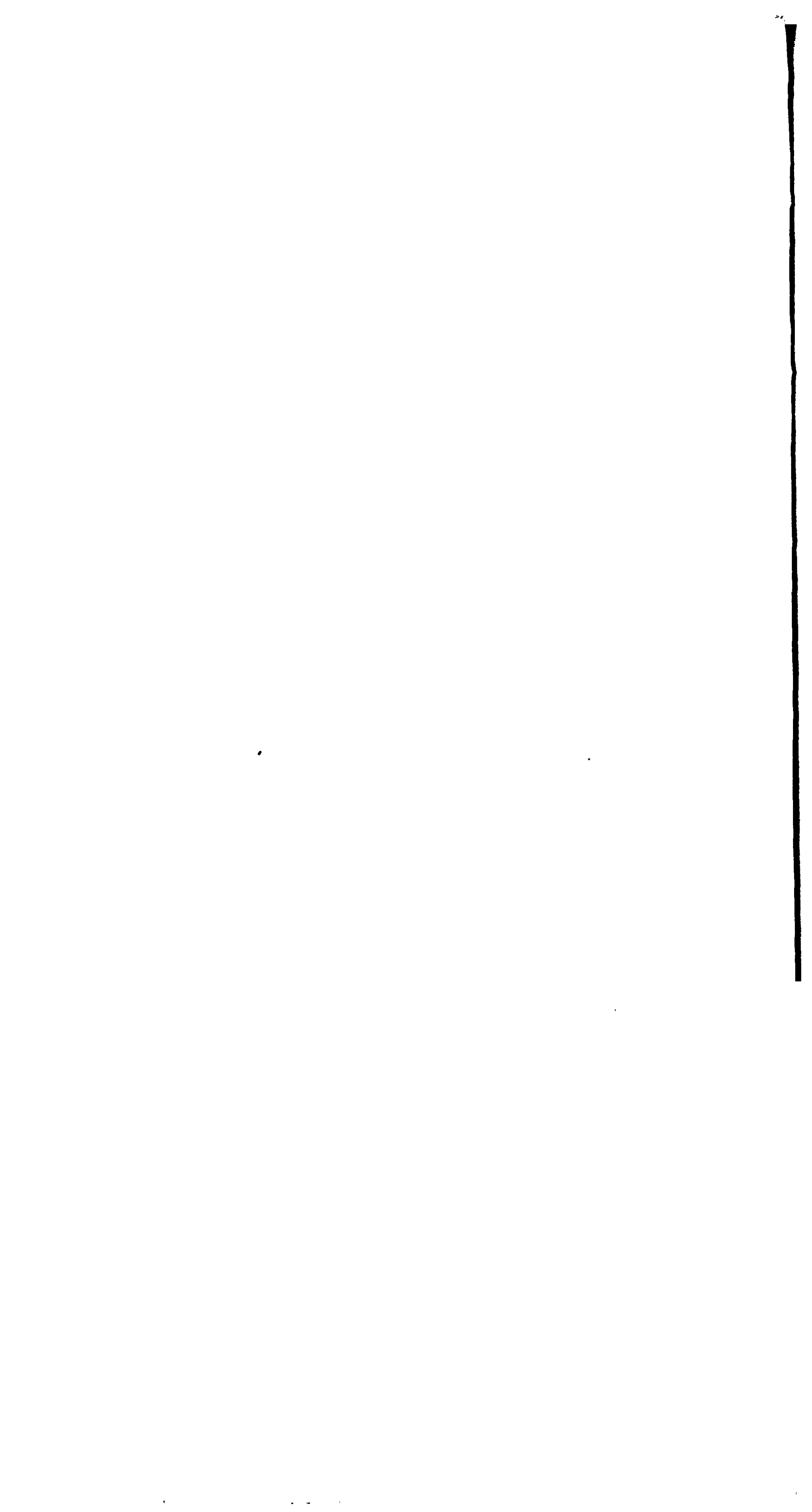
September 1969



SUMMARY OF FINDINGS

From 117 mailed questionnaires, 127 responses were elicited; the ten additional responses were from administrators who replied for more than one program. This return was gathered by mail and telephone during five days following delivery of the first questionnaires.

1. The respondents indicated that support for their educational programs, projects and institutions was received from many foundations in and outside of Cuyahoga County. Six percent indicated support from 21 or more foundations. Fourteen percent indicated support from six to twenty separate foundations.
2. Such support aided many kinds of education-related activity. Forty-one percent of the respondents indicated that foundation aid was given for new and experimental programs.
3. Fifteen percent of the respondents indicated total grants from foundations in excess of $100,000 during 1968 or 1969.
4. Twenty-eight percent of the respondents indicated that foundation support represented their program's total budget.
5. Fifty-three percent of the respondents indicated that, in their opinion, their programs would not have started at all without foundation support.
6. Forty-seven percent of the respondents indicated that they would have sought other funds from individual donors. Many of these commented upon the difficulty of doing so.

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In comments written on the backs of questionnaires, respondents indicated that:

1. Foundations provide funds for innovative programs. Respondents said that some of these programs have little immediate popular appeal, so foundations are their only likely fund source.
2. Foundations have moved with great speed to fill imperative cash needs within some programs.

SCOPE OF SURVEY

The research team compiled a list of institutional and non-institutional educational programs in Cuyahoga County that received grants-in-aid from one or more foundations in 1968 and/or 1969. These foundations are The Cleveland Foundation, Greater Cleveland Associated Foundation and The Martha Holden Jennings Foundation. The administrators of the grants were then approached for facts and opinions. Care was taken to separate and identify these in this report.

In many respects, the report is a general evaluation of the subject. However, much data were collected and are presented and analyzed herein. All responsibility for the accuracy of the data contained in this report is assumed by Urban Reports Corporation, Cleveland, Ohio.

GRANT RECIPIENT MAILING LIST

Administrative Consortium of
Heidelberg, Hiram, Oberlin and Wooster

Cooperative Urban Studies Program

American Negro Emancipation Centennial
Authority, Ohio Division

Grant for updating documentary film

Baldwin Wallace College

Academic program development
Development (buildings)
Humanities Institute
Student Aid

Case Western Reserve University

Biology Field Station at Valley View Farm
Biomedical Engineering (faculty enlargement)
Building Fund -- Law School
Building Fund -- Case Building Fund Campaign
Continuing Changes in the Arts Program
General Educational Purposes
Graduate Program in Public Management Science
Industrial & Foundation Graduate Fellowships
Inner City Teacher Training Program
Junior Scholar Program
Literature Conf. for Inner-City Children
Lectureship in Urban Housing
Management Development Project

Medical School
Design and Evaluation of Instructional Material
Endowment Capital
Faculty Salary Supplements
Feasibility Study of Prof. Group Practice
Medical Center Development Program
New Construction
Operating Support
Remodeling Labs
Research and Research Training
Special Travel for Faculty and Students
Student Scholarships

Library School Scholarships
Demonstration Equipment
Faculty Research

Pilot Project in Training of Teachers of Disadvantaged
Upward Bound

Cathedral Latin School

Community Education Program

Catholic Board of Education

Training teachers for slow learners

Children's Services

Building and equipment

Children's Theater of Shaker Heights

Drama awards to graduating students

Cleveland Area League for Nursing

Nursing scholarships

Cleveland Board of Education

Expenses for teachers attending NDEA
Job Development Center
Prof. staff conferences for school principals
Workshop for secondary and elementary school principals
Visiting Scholar Program

Cleveland Center for Research in Child Development

Training program in psychoanalytic child psychotherapy

Cleveland Guidance Center, Inc.

Teacher education

Cleveland Health Museum

Health education

Cleveland Heights Board of Education

"Russian Abroad" Program

Cleveland Institute of Music
Deficit funding
Eurhythmics for public school teachers and supervisors
Faculty salary supplements
Implementation of merger with CWRU
Memberships
Scholarships

Cleveland Job Corps Center for Women

Training Workshop for Corpsmen and Staff

Cleveland Music School Settlement

Music therapy program

Cleveland National Association for the Advancement of Colored People

Afro-American History School

Cleveland State University

Division of Continuing Education -- new and experimental programs
Educational Leadership Practicum for Public Schools

Cleveland Society for the Blind

General Support

Cleveland Welfare Federation

Summer Work Experience
"Careers in Social Work"
Scholarships in Graduate Education in Social Work

Council on Human Relations
The Green Circle Program

Cuyahoga Community College
Project Search
Student Financial Aid

Cuyahoga County School District

A study to develop regional computer capability for school districts in Northeastern Ohio

Cuyahoga County School Superintendents Association

Organizational Funding
Seminar on Teacher Negotiations
Teacher Training -- Family Living Institute

East Cleveland City Schools

Picture Lady program

Educational Development Center

Research into causes of college dropouts and their effective rehabilitation

Educational Research Council of America

Teacher education

Educational Television Association

Buildings and equipment
Operating budget

Euclid Public Schools

Human Relations Workshop

Greater Cleveland Associated Foundations

ASPA Summer Internship in Public Administration

Greater Cleveland Growth Association

Job Skills Survey

Greater Cleveland Neighborhood Centers Association

"Neighbors Now" Building Campaign

Hawken School

Elementary art works
Film Makers Day Program
Fourth Annual Festival of Arts
Scholarship and Transportation of Funds
Summer Enrichment Program

Jennings Foundation

Master Teachers Fellowship Program
Master Teachers Program -- summer research support
Special Jennings Scholar Program
Summer Fine Arts Scholarship

John Carroll University

In Service program -- teachers of slow learners
Scholarship and special training for high school teachers in the area of Democracy vs. Communism

Lakewood Board of Education

Space Science

Natural Science Museum

Education -- public programs
Lecture series on "Search for Survival"
Mentor Marsh Nature Reserve

Notre Dame College

Capital Improvements
Project Insight

Plan for Action for Continuing Education Association (PACE)

Citizens Look at School Systems
Early Reading Assistance
Human Relations Curriculum Dev.
Operating Expenses
Teacher Instant Mini-Endowment
Teacher-Leadership Awards

Parma School District

Implementation of Social Studies Curriculum

Police Athletic League

Customized educational training

Project Work

Motivation visits for 8th grade students
Older Worker Youth Demonstration Project
Operating Expenses
Reading is Fundamental program
Woodland Cooperative High School

Shaker Lakes Regional Nature Center

Program development for several school systems

Summer Arts Festival

Arts workshops for inner city children

United Negro College Fund

For institution-awarded scholarships

University Hospitals

To teach diabetic patients self-care

University School

Development program
Endowment Fund
Institution-awarded scholarships
Summer Science Project 1968-1969
Support of Educational program
Support of Operating budget
Winter Science Project 1968-1969

Ursuline College

Buildings and equipment
Scholarships to individuals

Western Reserve Historical Society

Buildings and equipment
Endowment
Exhibits
Experimental or new educational programs
Faculty enlargement

A total of 127 questionnaires was returned and analyzed. The tabulations indicate that 41 percent of the grant recipients sought money for experimental or new educational programs. The second largest category of requests (23 percent) was for money for teacher education programs (see Question 1, page 12 of this report).

Approximately 59 percent of the grant recipients received less than $25,000 in 1968-69, but 15 percent were granted in excess of $100,000. A list of those institutions which received over $100,000 and the amounts they received in 1968 or 1969 appear below.

Institutional Grants in Excess of $100,000, as Reported

1968

Baldwin Wallace College	$ 289,000
Case Western Reserve University	1,995,500
The Cleveland Society for the Blind	161,000
The Cleveland Summer Arts Festival	274,000
University School	711,907
Ursuline College	268,000
	$3,699,407

1969

Case Western Reserve University	$4,537,107
Educational Television Association	129,500
Educational Research Council	423,700
"Neighbors Now" Building Campaign	150,000
PACE Association	125,000
The Cleveland Summer Arts Festival	274,000
University School	383,912
	$6,023,219

Fifty-two percent of the recipients reported that foundations provided more than 50 percent of each of their programs' total annual budgets. Furthermore, 28 percent said their entire budget was provided by foundations. (See Question 3, page 13.)

In Questions 4 and 5, the opinions of the grant administrators were solicited. When asked what would have happened if foundation support had been withheld, over 50 percent of the respondents said their programs would not have started at all, and 47 percent said they believed their projects would have been delayed or would have had to lower targets.

Should foundation funds become unavailable, the program administrators indicated that they would try every other source for funds, with 47 percent stating that individuals would be asked to contribute and 41 percent believing that corporations would be approached for funding.

The following table of responses is presented in the format of the questionnaire which the respondents completed and submitted. The percentages of their replies are listed to the left of each question.

N=127

*1. This program primarily involves:

14% - 1. Buildings and equipment
8% - 2. Unrestricted endowment
23% - 3. Teacher education
41% - 4. Experimental or new educational programs
17% - 5. Institution-awarded scholarships
12% - 6. Scholarships awarded directly to individuals
2% - 7. Non-scholarship student aid
10% - 8. Faculty enlargement
22% - 9. Other (please specify): Operating expenses, faculty salaries, faculty development & research, special surveys & data analysis, various programs for public education on specific problems, e.g., pollution.

N=123 2. How much money did this program receive in either 1968 or 1969 (choose most representative year) from any or all foundations? (check one)

2% - 1. Less than $1000
20% - 2. Less than $5000
16% - 3. Less than $10,000
21% - 4. Less than $25,000
18% - 5. Less than $50,000
6% - 6. Less than $75,000
2% - 7. Less than $100,000
15% - 8. More than $100,000 (Actual figure, if in excess of $100,000):

Year	Amount	Recipient
1968	$ 289,000	Baldwin Wallace College
	1,995,500	Case Western Reserve University
	161,000	The Cleveland Society for the Blind
	274,000	The Cleveland Summer Arts Festival
	711,907	University School
	268,000	Ursuline College
	$3,699,407	
1969	$4,537,107	Case Western Reserve University
	129,500	Ed. TV Association
	423,700	Educ. Research Council
	150,000	"Neighbors Now" Building Campaign
	125,000	PACE
	383,912	University School
	274,000	The Cleveland Summer Arts Festival
	$6,023,219	

This support was provided by how many foundations?

80% - 1-5
10% - 6-10
4% - 11-20
6% - 21+

* Multiple answers resulted in totals of more than 100%.

N=127 3. What percent of the program's total budget for that year did this money represent? (check one)

4% - 1. Less than 1%
4% - 2. Less than 5%
10% - 3. Less than 10%
6% - 4. Less than 20%
7% - 5. Less than 30%
17% - 6. Less than 50%
11% - 7. Less than 75%
13% - 8. Less than 100%
28% - 9. Represents the total budget for this program

N=126 *4. Without foundation support, this project: (check as many as apply)

53% - 1. Would not have started at all
23% - 2. Would have been delayed
0% - 3. Would have received the same amount elsewhere
24% - 4. Would have lowered its targets
8% - 5. Would have cut expenses but maintained its target level
2% - 6. Would not have been noticeably affected
6% - 7. Other (please explain): Without foundation support money would come from endowment fund. Institutional efficiency would be severely hampered. Programs serving a relatively small and special group would never be funded.

N=122 *5. If foundations were not able to provide any assistance to this program, where would you be likely to seek alternative funds? (check as many as apply)

18% - 1. Public fund-raising campaigns
41% - 2. Corporate contributions (other than corporate foundations)
47% - 3. Individual donors
9% - 4. Local government sources
17% - 5. State government sources
31% - 6. Federal government sources
16% - 7. Other (please specify)
27% - 8. Would discontinue program

* Multiple answers resulted in totals of more than 100%.

REPRESENTATIVE COMMENTS FROM BACKS OF QUESTIONNAIRES AS REQUESTED IN QUESTIONNAIRE ITEM NUMBER SIX:

1. "There was and is a need for teachers qualified to teach family living. What teaching will consist of is also important.

"With foundation help our Association (also funded with foundation money) became the focal point in developing a "Guide to Family Living," in training teachers for the above, in bringing two local universities together in teacher training and in providing the impetus to get one university to recommend that it take on the training of teachers in this area as soon as possible.

"Without foundation money none of this would have happened."

Program was titled: Family Living Curriculum Guide and Teacher Training Institute for Family Living. Program received between $25,000 and $50,000 from two foundations.

2. "For this particular program funding by any level of government probably would not be possible. Government funding under the Higher Education Act is generally restricted to demonstration programs and must go through a university.

"Assistance for the program might be available through a local university; however, those funds are limited. The university might also wish to restrict participation to only its students. An advantage of the present program is that it is able to attract students from a number of different universities throughout the United States."

Program was titled: ASPA Summer Internship in Public Administration. It is a summer employment program for college seniors.

3. "Funds for psychoanalytic programs are most difficult to obtain. The government agencies were "oversold" on psychoanalysis after the war and have soured on it. The uncertainty of long range government funding rules it out for us.

"Funds for basic research, long range training such as ours are difficult to obtain because of the current emphasis on crash programs for masses of people.

"Only the personal knowledge of our work, our people, available to local individuals and foundations, enables us to succeed.

"The program described here is also funded in approximately similar amount by a second local foundation."

Program was titled: Training Program in Psychoanalytic Child Therapy. It is experimental.

4. "The grant awarded by the Greater Cleveland Associated Foundation was specifically for research into the causes and effective rehabilitation of students, with potential, who fail out of college. It has been our experience that relatively few individual donors are willing to make substantial gifts to a research program. As a result, we have large amounts of data accumulated over the past five years which have not received the statistical treatment necessary to make it meaningful. The foundation, on the other hand, is cognizant of the need for basic research and supports it."

Grantee is: The Educational Development Center. Grantee received more than $25,000 but less than $50,000.

5. "For our purposes, it is more advantageous to receive financial support from a local foundation rather than from the federal government. The local foundation is knowledgeable of the institution to which it gives support, and, in the case of the Jennings Foundation, maintains a personal interest in the program to which it makes a grant.

"A main disadvantage in federal funding is that restrictions often are harmful, as indicated below. For instance, some of the most vital parts of the Baldwin Wallace Humanities Institution programs could not be supported by federal funds because of the all-inclusive nature of our project. There is the added disadvantage of a small college not being able to compete with the great universities of national reputation. In addition, federal funding in many cases is for one year and there is no guarantee of support for subsequent years. The foundation which has supported the Baldwin Wallace program was able to render assistance for a four-year period." --Dr. Neille Shoemaker, Chairman, Humanities Div., Director, Humanities Institute.

Program received $55,000 in each of 1968 and 1969. It is an experimental program involving teacher education and development, plus development of materials.

6. "This program, supported in large part by the Martha Holden Jennings Foundation, has enabled a young university to initiate a graduate program in school administration for a carefully selected group of sixty school principals in urban and suburban Cleveland, with the unified endorsement and support of superintendents from thirty-three school systems. We have thus been able to establish a program based on genuine current needs, with regard to school learning and school community relations, rather than go the usual route of offering conventional courses to prospective principals with no current leadership role. We will now be able to follow this pattern with graduate programs and in-service education "courses" with public funds almost exclusively. In substance, this has set us on the road to a problem oriented curriculum with much public support. A side benefit has been our ability to attract a new professor of school administration from a superintendency whose imagination has been captured by what we have begun and the expanded possibilities growing out of it for educational leadership improvement."

"As a final note, I have taken personal direction of two programs in the College of Education because of their far reaching potential value. One of them, funded by the U. S. Office of Education, is designed to being the University, the Cleveland Public Schools, and the citizenship spokesmen together for initiating a school centered program for preparing teacher trainers. The other is the privately supported Educational Leadership Practicum. From the standpoint of this University, both the public dollars and the private foundation dollars will have more impact because of each other. The state and federal government could not have responded so promptly, if indeed at all, to the strategic opportunity that developed by the small subvention of private philanthropy. Conversely, the stimulus grants of foundations could not underwrite the expanding program to be developed from public funding at the state level."

Program was titled: Educational Leadership Practicum for Public School Principals. The administrator is Dean of the College of Education in Cleveland State University.

7. "All of the other procedures for seeking funds would have been far more costly because far more time consuming. Disadvantages of governmental funding are as follows:

1. They are increasingly restricted and usually require an impossible degree of matching

2. They usually require application so long in advance of actual funding as to seriously reduce flexibility and responsiveness to community needs

3. They consume an inordinate amount of staff time because of bureaucratic detail

"The alternative of seeking funding would be to charge the client the full cost of the program. In the case of teachers and school districts, this is not feasible."

Program was titled: Contemporary Changes in the Arts Program. It was conducted within Case Western Reserve University. A single foundation grant of less than $5,000 provided between 75 and 100 percent of its budget.

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8. (1) "Need an organization to organize a public fund-raising campaign, and it doesn't make sense for special focus programs that are on a relatively small scale.

(2) "The search and persuade process is too exhausting and corporations are not likely to be interested in innovative and ground breaking programs as against other claims of a more traditional nature.

(3) "Run into all kinds of idiosyncratic decision rules that represent unbelievably odd orientations to the granting of funds and desirability of programs and perspectives on social needs and benefits. Moreover, very few individuals can make a grant in the $25,000 range, usually spread themselves out on marginally small grants.

(4) "Local governments have no money to spend on other than operating functions. They are deficit systems and will not risk funds to get into social innovations.

(5) "State governments don't know what the hell urban needs are or what local situations are like and have no real connections with the local scene. Moreover, the personal idiosyncracies of partisan politics will just exhaust and disgust anyone trying to do anything. An outside person has no leverage and ideas as such count for nothing in political in-fighting for advantage.

(6) "For the Federal government, what you do has to be consistent with political program and policy of the "ins" at the time. Moreover, never know who decides and on what basis--unless you have an inside connection who wires you into the cash flow channels. Finally, like all political structures, there has to be an advantage for the organization and its personnel independent of the merit of the proposal. A politically exploitable potential is the "kicker" required beyond the merit of the proposal."

Respondent's program was a series of Black Management Development Seminars conducted by Case Western Reserve University. Two foundations covered its total budget of between $10,000 and $25,000 in 1968.

EAGLEBROOK SCHOOL
Deerfield, Massachusetts

August 20, 1969

The Honorable Russell B. Long, Chairman
Committee on Finance
United States Senate
Washington, D. C.

Dear Mr. Long:

Because Eaglebrook is an independent school largely supported by private contributions, I am extremely concerned about some aspects of the tax reforms presently being considered by the Congressional Committees involved.

There is no question in my mind that some reforms are desperately needed. However, measures that might reduce the incentives to support philanthropic and educational institutions do not fit my definition of "reforms." I refer specifically to the legislation that would place limitations on deductions for gifts of appreciated property.

I know that as an independent school we are not alone in relying heavily upon this specific source of income. During the past fiscal year we have received approximately $82,500 from donations of appreciated stocks. Even when this amount was added to our other sources of income we still experienced a deficit. Any measurable reduction of the $82,500 figure could have been termed disastrous.

In addition, we have just embarked upon a major and urgently needed capital improvement program, the cost of which will be several million dollars over the next few years. Traditionally, support for such programs has come largely in the form of appreciated property. At the present date we have pledges in the amount of $210,000 that we know will be coming to us in this form.

On a national scale our figures are infinitesimal. It seems to me that passage of any such limitations is likely to open a Pandora's Box of financial woes for most of the nation's private schools, museums, hospitals, orchestras etc. Certainly many of these may be forced to close their doors - or alternatively - draw upon the public sector for financial support. It does not appear to me to be in the national interest for Congress to take such a risk.

I fervently hope that alternative programs will be carefully considered that might affect the necessary reforms without endangering the status of this vitally needed source of support.

Sincerely,

OSC:RP

O. Stuart Chase, Headmaster

AM

AMERICAN ASSOCIATION OF UNIVERSITY WOMEN

2401 VIRGINIA AVE., N.W. / WASHINGTON, D.C. 20037

Phone 202/338-4300

September 12, 1969

The Honorable Russell Long
Chairman, Senate Finance Committee
United States Senate
Washington, D.C. 20510

Dear Senator Long:

The American Association of University Women is comprised of approximately 175,000 women graduates of colleges and universities, organized in 1,660 local branches and in fifty state divisions. This Association has long been interested in the improvement of our colleges and universities and in extending opportunities for higher education to all qualified young people. To that end, we have supported many Federal-state education programs enacted by the Congress in recent years, and have endeavored to explain to the public the meaning of these programs and the need for additional support of higher educational institutions, both public and private.

The American Association of University Women Educational Foundation, established in 1958, is the avenue through which Association members channel their charitable and public service funds. This Foundation's primary activity is the granting of scholarships and fellowships to women students, principally at the graduate and post-doctoral level. The monies for this program -- the present endowment is approximately five million dollars -- come from contributions from AAUW members, usually in dimes and dollars, not in hundreds of thousands.

In presenting this statement, I ask, on behalf of the AAUW, that the Senate Finance Committee give serious consideration to reducing the proposed tax on foundation income. We ask also that the Committee delete from the House-passed tax measure the provision to include appreciation on donations of property to charities, colleges, and other tax-exempt activities in the Limit on Tax Preferences and the Allocation of Deductions.

We believe these proposals would have a deleterious effect upon the colleges and universities and upon charitable foundations supporting educational activities. Our Association has long supported the position that both public tax support and private giving are essential to maintenance of a free and healthy educational system. We are deeply concerned that the above mentioned provisions in the House-passed tax reform bill will reduce incentives to charitable giving.

Members of the AAUW are fully aware of the need for tax reform, for a more equitable distribution of the tax burden, and for the closing of loopholes which have permitted some taxpayers to avoid their share of the burden. We applaud this Congress for undertaking the

onerous task of revising tax legislation. Yet we also ask that institutions and foundations dependant upon charitable giving not be injured in the name of tax reform.

Sincerely yours,

Alice Beeman

Alice Beeman
General Director,
American Association of
University Women

Wheaton College WHEATON, ILLINOIS 60187 • TELEPHONE 312/682-5000

SINCE 1860 "FOR CHRIST AND HIS KINGDOM"

OFFICE OF THE PRESIDENT

September 12, 1969

The Honorable Russell B. Long, Chairman,
And Members of the Senate Finance Committee
2227 New Senate Office Building
Washington, D. C. 20510

SUBJECT: WHEATON COLLEGE STATEMENT ON H.R. 13270

Gentlemen:

Wheaton College is a private, interdenominational, coeducational, fully accredited liberal arts Christian college of 1700 full-time students located in Wheaton, Illinois, about twenty-five miles due west of Chicago. It offers courses leading to the bachelor's degree in arts, sciences and music in six basic divisions of study, with majors in some thirty academic fields. It has a graduate school of theology accommodating more than one hundred students offering the Master of Arts and the Master of Divinity degrees. Since its founding in 1860 with the motto "For Christ and His Kingdom" it has had but five presidents and has sought to provide a liberal education that introduces its carefully selected students to the organized fields of learning and presents the Christian theistic view of the world of man, and of man's culture in the light of Biblical and natural revelation. Its faculty numbers 150, more than 40% of whom have earned doctoral degrees. Students come to Wheaton each year from nearly every state and from some 30 countries. Regularly, 75% of its students come from outside the state of Illinois. A third of Wheaton's graduates enter into some phase of education professionally, and currently twenty-four alumni serve as presi-

dents of institutions of higher education. Among its nearly 15,000 alumni, perhaps Dr. and Mrs. William (Billy) Graham are best known and epitomize the purpose of the College to encourage meaningful Christian service from its graduates to mankind everywhere. Wheaton is conservative in its theological position and, in harmony with its Christian faith, continues to uphold, with sound scholarship, the principles upon which our nation was founded.

In an effort to maintain its academic and religious independence it has sought to gain its support from individuals, business interests, foundations and local churches (representing most of the evangelical denominations throughout the United States) rather than from Federal funds. In the last two decades, due to that private support, fourteen major buildings have been added to campus facilities increasing plant assets by nearly $9,000,000. The buildings and plant expansion mentioned above would not have been possible without the transfer of donor gifts with substantial capital appreciation. We observe that donors' capital appreciation is translated into essential educational facilities and current operating funds.

We have carefully studied the provisions of the proposed Tax Reform Bill (H.R. 13270). We are definitely in favor of those provisions of the Bill which curb long standing abuses and inequities such as the provisions dealing with the taxation of debt financed income and the extension of the unrelated business income tax to churches and religious organizations. We are also of the opinion, however, that certain provisions of the Bill, if enacted into law, would substantially discourage the making of gifts to

all educational and charitable institutions and would also have an adverse effect by taxing gains on deferred gifts that have already been made to such institutions. The following is a summary of those provisions that we believe would have a detrimental effect on giving to our institution and thus on our ability to educate young people to assume roles of leadership and responsibility in our society.

I. SPECIAL LIMITATIONS IMPOSED ON GIFTS OF APPRECIATED PROPERTY.

We are opposed to those provisions of the Bill which would discriminate against gifts of appreciated property. These provisions include the special percentage limitation on the deductibility of gifts of appreciated property, (i.e., 30% of contribution base instead of 50%) and the limitation on the contribution deduction for gifts of future interests of appreciated property.

There is no sound basis for placing a more restrictive limitation on such gifts. Similar limitations have been considered in the past and have been rejected because it was recognized that charitable gifts of appreciated property should be generally encouraged. (S. Rep. No. 1567 75th Congress, 3rd Session 1938). Last year approximately 50% of the total gifts received by the College were gifts of appreciated property. These gifts were essential to meet the expense of current operations. A reduction in annual gifts of appreciated property would certainly limit and curtail the educational program of the institution.

The limitation on the deduction of gifts of future interests of appreciated property (i.e., the Donor's cost basis) will severely handicap current and future programs of educational institutions. As a practical matter this provision may completely eliminate the use of gift annuity contracts and life income contracts when appreciated property is involved.

During the last two years the College received $2.2 million under gift annuity contracts and just over $1 million under life income agreements. Although these are classified as deferred gifts the College received substantial present benefits from these gifts. Because of the sound investment policy and actuarial experience last year, the College was able to use approximately 25% of the total amount of each deferred gift annuity received for current operations. In addition the College was able to make plans for future programs knowing that fixed amounts of principal had been irrevocably designated and set aside for the use and benefit of the College. These are distinct present benefits, benefits which would be lost if the present provision was enacted into law. During the past two decades the College has received more funds from deferred gifts of appreciated property than any other form of gift.

II. CHARITABLE DEDUCTION FOR ESTATES AND TRUSTS. The proposed Bill contains a provision limiting the annual charitable deduction for estates and trusts to amounts which are actually paid to charity. The effect of this provision is to impose a tax on realized gains from property which has been irrevocably set aside and designated for charitable purposes. This provision is apparently supposed to encourage current distributions to charity; however, in actual operation it will have the effect of reducing the net amount available to charity. Since this provision is applicable to life income trusts already in existence, and since these trusts are irrevocable and not subject to change, there can be no increase in current distributions; instead a tax will be imposed annually on realized gains thus reducing the net amount available for charitable purposes. The property received under a charitable remainder trust has the same cost basis in the hands of the

Trustee as it had in the hands of the Donor; therefore, the tax will be imposed not only on the gain realized after the transfer has been made for charitable purposes, but also the unrealized gain attributable to the period when the property was in the hands of the Donor. This not only imposes an undue tax burden on the institution but also will result in additional accounting and other problems for those institutions administering charitable trusts.

It is also possible that this provision would be applicable to the typical life income agreement, and the common fund held by many institutions for the administration and investment of funds received under life income agreements. If the rule were applicable to these situations it might also be applicable to other segregated endowment or other income funds held by charitable institutions. The enactment of this provision without well defined exceptions or limitations to cover the foregoing described inequities will result in an undue tax burden and hardship for charitable institutions.

III. THE UNIT TRUST, LIMITED TAX PREFERENCE AND BARGAIN SALES.

The Unit Trust concept, which has been used in the proposed Bill as a standard for qualifying charitable remainder trusts, is a concept which is untried and has many uncertainties. For example, it would appear that under this rule any transfer of appreciated property to a Unit Trust would result in a taxable sale or exchange with the Donor being taxed on the difference between the value of his annuity or fixed payment interest in the trust and the cost basis of the property transferred. There is no apparent coordination between this provision and the provision requiring a taxpayer making a gift of a future interest of appreciated property to elect either to pay a tax

on the full appreciation or use his cost basis as the charitable deduction. We submit that the abuses which are intended to be corrected by this provision can be more simply corrected by requiring independent trustees, i.e., that is a Trustee other than the Donor for all charitable remainder trusts and requiring all such trust agreements to contain restrictions on the investing powers of the Trustee.

The limited tax preference and allocation of deduction provisions are extremely complicated. The charitable deduction, the unrealized appreciation in gift property and the unrealized portion of long term capital gains, all figure in the computation. As a result it will be extremely difficult to advise a prospective Donor of a major gift as to the tax implications of that gift. A charitable gift is a voluntary act and it has been our experience that although the tax incentive is not the sole incentive for making a gift, it is important to each Donor. If the Donor is uncertain as to the tax implications of his gift or if there is a possibility that he may incur a tax as a result of the gift or in some way reduce his other deductions by reason of the gift, then he will be persuaded to fatal inaction and the gift will never be made.

The provision dealing with the taxation of bargain sales will have a detrimental effect on gift annuity transactions. We submit that if this provision is retained, there should be added a special exception for gift annuity transactions similar to the exception which was added to the provison dealing with debt financed income.

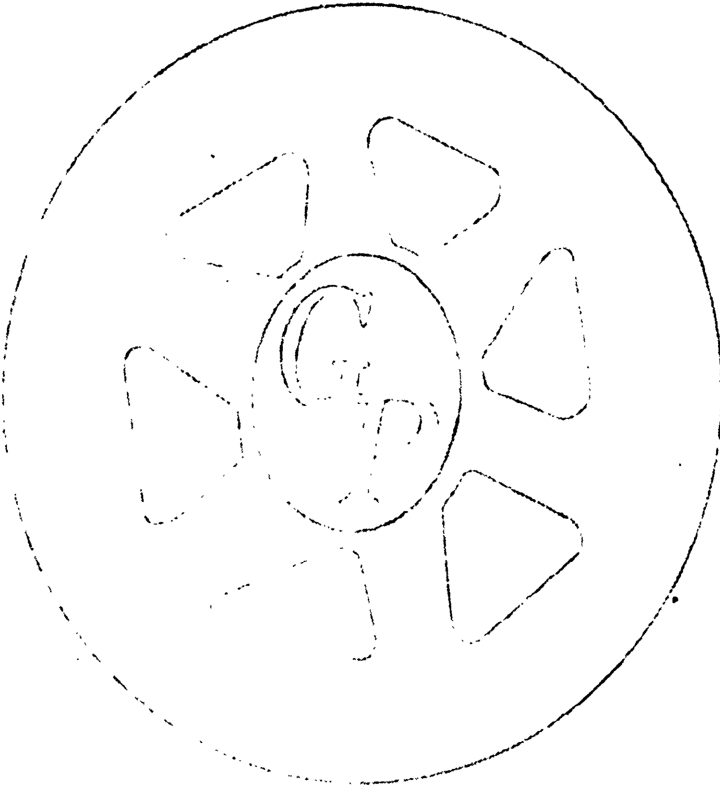
Historically, endowment funds have undergirded private college finances and have provided long-term strengths. In recent years deferred

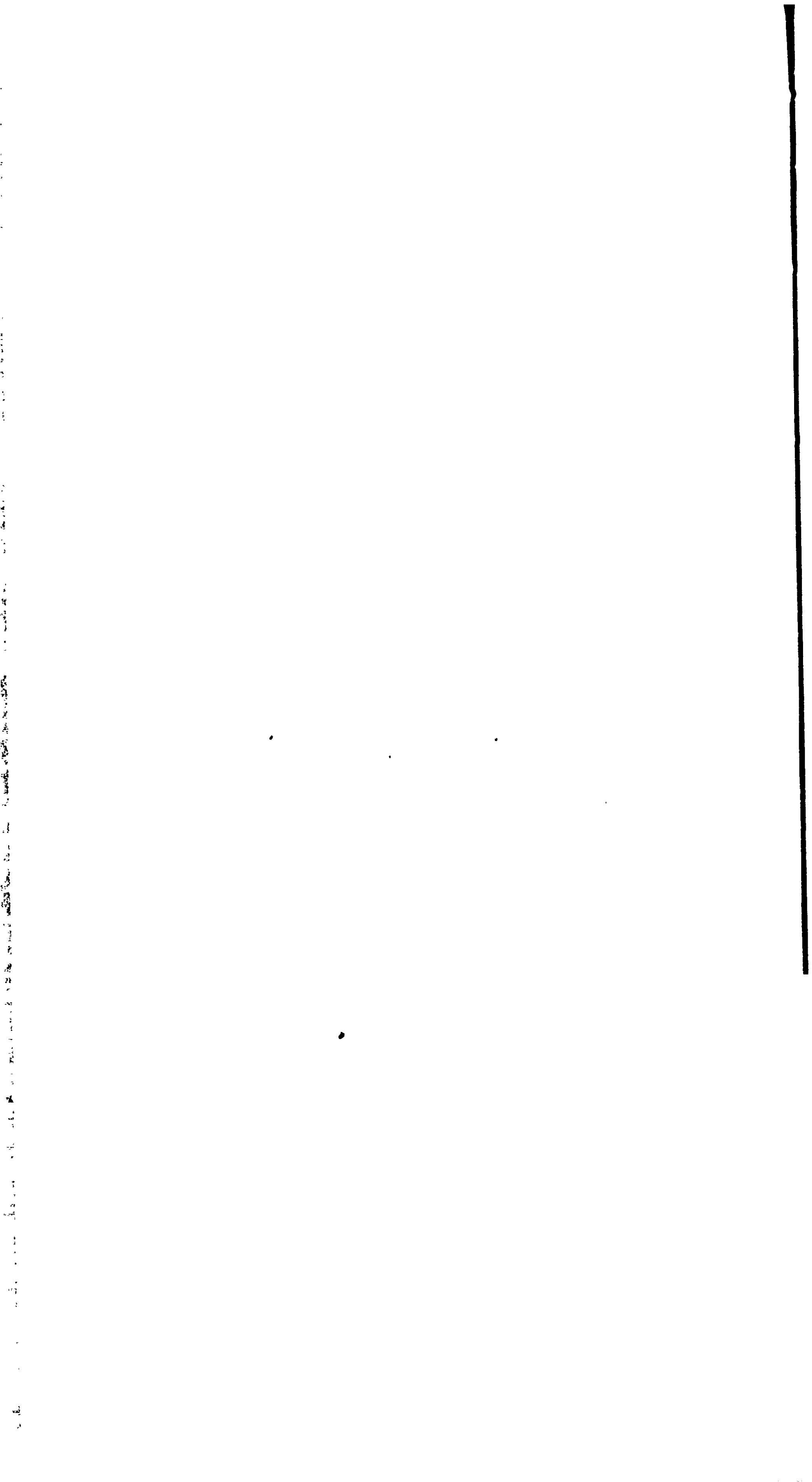
giving programs have complemented and supplemented the inadequacy of endowment funds. We think that the aforementioned provisions of H.R. 13270 would place in jeopardy our entire Deferred Giving program (particularly the Life Income Contract and Gift annuity programs) and would severely reduce the incentives for gifts for current operations.

Respectfully submitted,

HUDSON T. ARMERDING
President

HTA:ehl





STANFORD UNIVERSITY
STANFORD, CALIFORNIA 94305

OFFICE OF THE CHANCELLOR

September 12, 1969

The Honorable Russell B. Long
Chairman, Committee on Finance
2227 New Senate Office Building
Washington, D. C. 20510

Part 13 9-18

Dear Senator Long:

I am sorry that my request to testify in person was denied, but I understand why the number of witnesses has to be limited.

The need for tax reform has long been apparent; it has been the subject of much discussion. It is regrettable, therefore, that H.R. 13270 seems to have been passed with undue haste. Despite its several commendable provisions, it delivers a seriously damaging blow to the historic tradition of philanthropy and therefore jeopardizes the financial health of great institutions without providing even approximately commensurate revenue benefits.

In my judgment, the suggested treatment of gifts of property, specifically the inclusion of philanthropic gifts with the other items set forth in the provisions for Limited Tax Preferences and subsequently in the Allocation of Deductions, is wrong,--fatefully wrong. The deductibility of charitable gifts which benefit society as a whole is not the same as the other items in the LTP category. The philanthropic donor does indeed derive some tax benefit from his gift, and the Treasury suffers some loss of revenue because of it,--but the giver's net worth is reduced and society's welfare enhanced.

The provisions relating to the charitable remainder trust, which eliminate the advantages of the normally heretofore approved deduction for the gift and the charitable remainder, will cause incalculable damage to higher education. Many persons, if not most, who are philanthropically inclined, will refrain from making such contributions. They will retain appreciated property and, in consequence, there will be no benefit to the Treasury through capital gains tax, nor will the institution be able to inaugurate programs in the assurance that it can finance those programs with the dollars it has in hand in the expectation of later gifts.

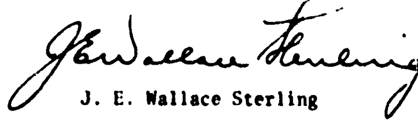
Finally, the announcement in August that April 22 was the effective date for charitable remainder trusts, life income contracts, gift annuities, short term trusts and bargain sales, introduced a retroactive provision which adversely affects both institution and donor, each of whom acted in good faith in entering into these transactions, only to discover that the tax result of the gift would, if the Bill were to be passed in its present form, be altered.

The net effect of the Bill will be to stop the flow of major philanthropic giving. If some of the restrictive provisions to which I have referred are enacted into law, privately supported institutions will diminish in quality and

strength; higher education will become dependent on more tax dollars; and the healthy mix of private and public support which has provided the distinction and broad base of our nation's higher education will be lost. Such loss is not in the best interest of this nation.

I take the liberty of enclosing a statement I made to Secretary Douglas Dillon on 29 November 1961, when I served as spokesman for a number of colleges and universities. I still believe strongly in that statement.

Sincerely yours,



J. E. Wallace Sterling

Enclosure

Mr. Secretary:

We appreciate greatly your courtesy and interest in receiving us this afternoon.

Educators at every level, including those in higher education, speak today of "the crisis" in education. And well they might, because there is one. But informed people are aware of this fact, and we have not come here to belabor it.

Nor have we come to plead that all educational institutions are altogether virtuous or are the sole custodians of virtue. We deplore lack of virtue among ourselves when it is manifest, and are eager and willing to exercise self-discipline to correct errancy and abuse. In the field of taxation, we seek the opportunity to cooperate with your office to identify and eliminate such abuses as may exist.

We have come, however, to plead with all the earnestness at our command the high value to all of United States Higher Education, both public and private, of a tax structure which is congenial and conducive to generous gift support of higher education. If a given institution has erred, or should err, in a way which is abusive to its privileged tax status, we would urge on you the wisdom and propriety of not penalizing the many for the fault of the one or the few. We are confident that ways can be found of disposing of the bathwater while preserving the baby in good health.

We cannot over-emphasize the value of gift support to higher education: It is literally vital to the private sector; it is essential reinforcement to the public sector.

We would plead also that unresolved tax issues affecting the flow of such gift support be resolved with all reasonable speed. Until there is such resolution and clarification, the flow of gifts will be retarded by a prospective donor's understandable uncertainty and concern as to the tax consequences of his gift. We make this plea with genuine appreciation of the magnitude and complexities of the responsibilities of your office.

Finally, we would urgently request that your office discuss with representatives of higher education such tax changes or clarifications affecting gifts to education as your office may have under consideration, before official conclusions are drawn and decisions made. And we respectfully suggest that the discussion we request be arranged with and through the American Council on Education.

Let me express again our gratitude for the opportunity you have accorded us of making this representation to you.

J. E. Wallace Sterling

29 November 1961

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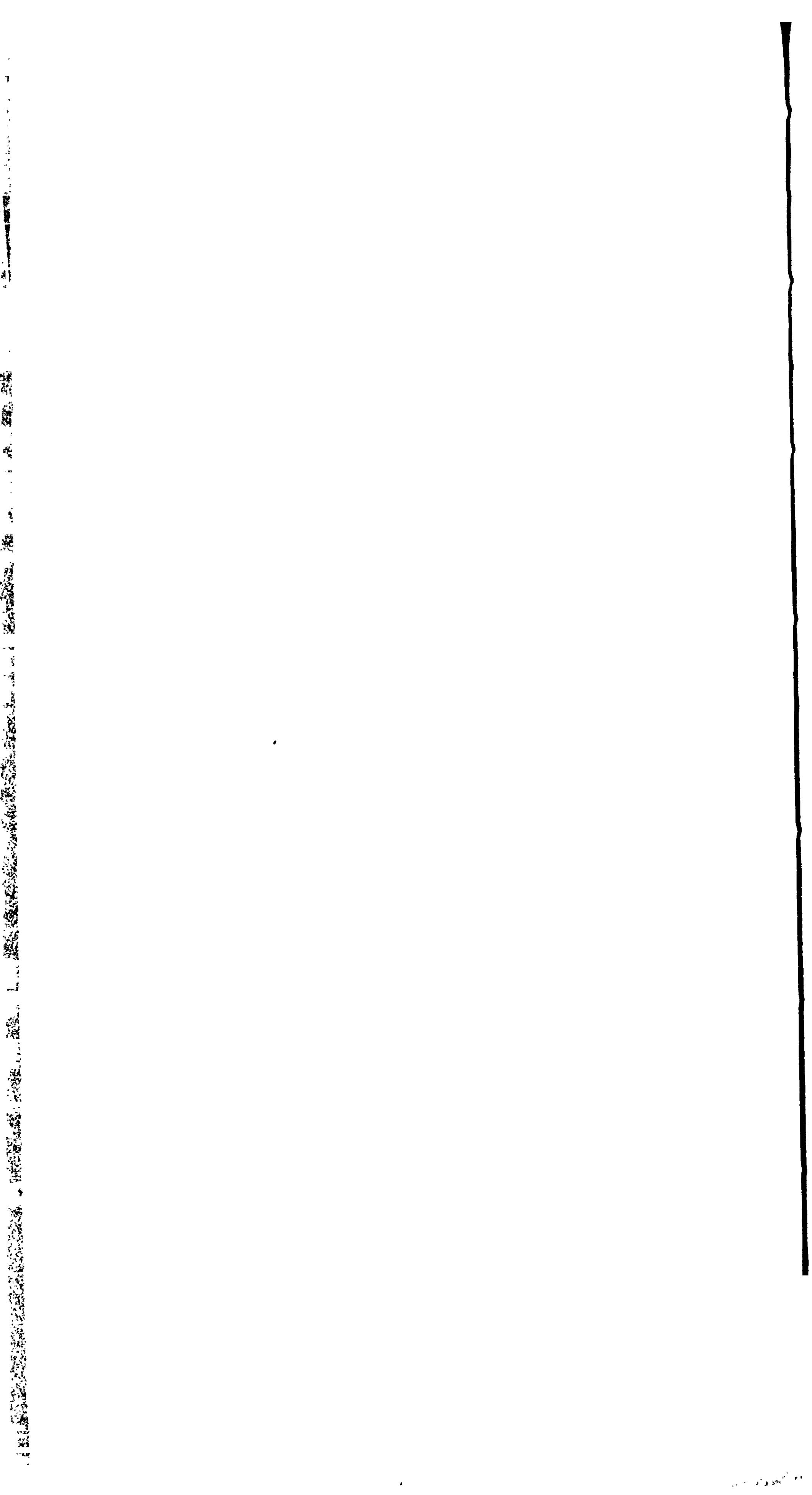

STATEMENT ON TAX REFORM ACT OF 1969
TO COMMITTEE ON FINANCE OF
THE UNITED STATES SENATE*

- - -

Presented by

ASSOCIATED COLLEGES OF THE MIDWEST:

Beloit	Cornell	Macalester
Carleton	Grinnell	Monmouth
Coe	Knox	Ripon
Colorado	Lawrence	St. Olaf

(See Exhibit 1-A)

and

GREAT LAKES COLLEGES ASSOCIATION:

Albion	Earlham	Oberlin
Antioch	Hope	Ohio Wesleyan
Denison	Kalamazoo	Wabash
DePauw	Kenyon	Wooster

(See Exhibit 1-B)

* Submitted by Sharvy C. Umbeck, President, Knox College.

September 16, 1969

SUMMARY OF

STATEMENT ON TAX REFORM ACT OF 1969
TO COMMITTEE ON FINANCE OF
THE UNITED STATES SENATE

Introductory Remarks........................ Page 1

Limit on Tax Preferences and Allocation of Deductions........................... Page 3

Comments on Charitable Contribution of Appreciated Property..................... Page 4

Comments on Future Interests Gifts......... Page 5

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Comments on Requirements for Filing Returns Page 6

Comments on Bargain Sales.................. Page 7

Comments on Unrelated Debt Financed Income (Clay-Brown Provisions)........... Page 7

Exhibits in Support of Arguments........... --

We commend and support those positive efforts of the Congress to improve tax administration and to support equity in application of the laws of the land. We support the idea that some type of minimum tax be levied on the income of all individuals who share the bounties of America. We support legislation designed to prevent the manipulation of the tax laws regarding tax exemption and charitable contributions for the sole purpose of achieving tax benefit. No one should achieve greater wealth by such use of the tax laws.

1. We support elimination of the unlimited charitable deduction coupled with raising the general limitation on all contribution deductions to 50% of the contribution base provided that the severe restrictions proposed as to gifts of appreciated property are removed as explained below.

2. We support the provision which would eliminate abuses in the gifts of short-term income interests and in the gifts of the use of property and in the gifts of inventory or other property which, if sold, would give rise to ordinary income.

3. We support provisions which would eliminate the possibility of a taxpayer realizing more actual dollars by means of making a charitable gift of a short-term capital asset than he would realize by the sale of such an asset.

   However, in the efforts at tax reform contained in H.R. 13270 we see measures of critical adversity to the long established policy of encouraging, by means of tax incentive, private philanthropy to support charitable and educational enterprises in the providing of essential public services which must otherwise be paid for by increased taxes.

There is no question that the demand for the provision of higher education to our citizens will continue to escalate. If private philanthropy is seriously curtailed, those colleges and universities independently supported will suffer erosion in their effectiveness; many will disappear.

The long established policy of tax incentive to private higher education has been often reinforced by the United States Congress. The Senate Finance Committee in 1938 vigorously recognized this:

> "Representations were made to the Committee by officials of educational and charitable institutions that the effect of such a provision would be to discourage the making of charitable gifts in property. The Committee believes that charitable gifts generally are to be encouraged and so has eliminated the provision of the House Bill."[1]

Likewise, later revisions of the Internal Revenue Code raised the limitation on the deductibility of such gifts from 20% to 30% of adjusted gross income.

This national attitude has helped the private sector and many nominally public institutions to grow with the nation, to provide a multi-faceted system of higher education which has greatly benefitted our people individually and the nation as a whole. Additionally, this encouragement of private philanthropy has forestalled additional costs in the public sector. Were it not for the privately supported institutions, the tax supported public colleges and universities would have to provide the facilities and programs to accommodate an additional two million students expected to enroll in private schools this fall. Enrollment in the 24 colleges of our associations has climbed from 28,100 to 40,100 in the past ten years.

In place of easing the tax burden, the opposite effect will prevail if private charitable giving is curtailed. Had these 24 colleges not existed, to provide the programs offered by them during the past decade would have required, in addition to endowment income, tuition and fees, at least $342,000,000 in tax revenues to supplant private gifts received.

It should be emphasized here that for a century and a half the role of the 24 colleges listed above has been highly significant in the broad spectrum of American life. Our graduates have provided leadership in public and private life, in the professions, in the arts and letters, and in the sciences. Exhibit 2 illustrates this point. Hence, from the point of

[1] (S. Rep. No. 1567, 75th Cong. 3rd Sess. 1938)

view of national self-interest, to discourage voluntary private philanthropy to such institutions is self-defeating.

In particular, we oppose the inclusion of the appreciation in value of property donated to charity in the "Limit on Tax Preferences" and "Allocation of Deductions."

In our judgment, two aspects of the attempts of the House of Representatives to levy some minimum income tax would, if adopted, have immediate and probably disastrous effect on charitable giving to colleges and universities, and especially to those privately supported.

The "Limit on Tax Preferences" is drawn to foster the fair distribution of our taxes. The language of the section treats the means by which some individuals exclude a large portion of their economic "income" from tax. (We underline the word "income.") The tax preferences as listed in H.R. 13270 are:

1. Tax-exempt interest on State and local bonds.

2. The excluded one-half of net long-term capital gain.

3. Depreciation of real property beyond straight line depreciation.

4. Excess farm losses.

5. Appreciation in the value of property donated to a charity.

It is to be noted that Items 1-4 above are truly cash producing to the taxpayer. They add untaxed dollars to his cash flow. They are income items related to property producing income or to property sold and exchanged for dollars. They are excluded income. For the purpose of allocating deductions, an additional "non-taxed" item is listed in the form of certain drilling expenses and depletion allowances. Obviously, Items 1-4 are designed to deal with the imposition of a minimum tax on all forms of income.

However, Item 5 above is not income. It should not be treated as a "non-taxed" item of income in the

"Allocation of Deductions" nor as an item of preferential income in the "Tax Preferences." Giving away appreciated property produces no economic income. True, the tax laws provide charitable contribution deductions for the market value of property given to charity. Such tax posture should be maintained. Controlling the tax incentive should be handled solely within the 50% limitation on charitable contributions proposed by H.R. 13270, and the 50% limitation should include the appreciated value of donated property -- including tangible personal property where valuation is reasonably acceptable.

Genuine philanthropy to colleges and universities has produced none of the serious abuses to which the two new proposals are directed. The very illustration used in the "Report of the Committee on Ways and Means . . . to Accompany H.R.13270 . . ." clearly demonstrates the areas where major abuse occurs -- the exclusion of real economic items such as the non-taxed one-half of long-term capital gain and the allowance of interest deductions for capital used to finance such capital gain. (See Page 80 of the Committee Report, House Report No. 91-413, Part 1.)

Gifts of appreciated property constituted in excess of 20% of total private gifts to our 24 colleges. The actual volume of such gifts has been $66,610,000. over the past ten year period. (See Exhibit 3) As presently cast, the "Limit on Tax Preferences" and "Allocation of Deductions" proposals will severely affect this important source of voluntary giving in support of our educational programs.

<u>We are also in opposition to the harmful effects of the provision regarding "Charitable Contribution of Appreciated Property."</u>

Adverse proposals regarding the treatment of appreciation in value of property donated to charity are found in Sec. 201 (a), (c) and (d) of the bill and Secs. 170 and 83 of the proposed code revisions under the broad title of "Charitable Contributions of Appreciated Property." We appreciate the recognition of the House of Representatives that this matter is of vital concern to colleges and universities which,

along with certain other charities, were excluded to a degree from the treatment proposed in this section. However, if the "Limit on Tax Preferences" and "Allocation of Deductions" sections do not also exclude gifts of appreciated property to colleges and universities (and the other named charities), their exclusion under Sec. 201 (c) will be largely illusory! As indicated above, gifts of appreciated property are highly significant to our 24 colleges.

Furthermore, with regard to gifts of future interests, the beneficial exclusion in Sec. 201 (c) was not extended. We speak now of the ordinary life income contract reserving a legal life estate in property to the donor with the remainder going to the college or university.

These gifts are highly significant to the development of college endowments and resources. They are most likely funded by gifts of appreciated securities or real estate -- both property with readily ascertainable market values!

To deny the deductibility of the appreciation in value in these cases is not consistent. It would also practically foreclose this area of "deferred giving development" to colleges and universities. Ten-year summaries indicate that the 24 colleges have received in excess of $20,000,000 in the gift value of remainder interests under life income contracts.* The full market value of the properties transferred exceeds this gift remainder value. It is this total value which will be eventually available to the colleges at the expiration of the life income interests involved. If there are areas of abuse regarding these gifts, such abuse can be corrected by tightened appraisal requirements.

Sec. 201 (a) (8) likewise is excessively restrictive because it would limit a charitable contribution deduction for an ordinary remainder interest after a life estate in property to such an interest conforming to the sections governing gifts in trust. Where the college or university is the trustee or in the case of legal life estates and remainder interests (and their counterparts in personal property), the actuarial value of the remainder to the institution based on market values of the property involved should be retained <u>in its present form</u> as a charitable contribution.

*See Exhibit 4

These gifts, upon the decease of the donors, will provide scholarship endowment and other program support, thanks to the generosity of those donors who have parted voluntarily with a share of their wealth. Problems of valuation of the charitable remainder interests can be successfully attacked primarily by means of correct property appraisals and by means of periodic modification of actuarial and discount tables.

We strongly oppose the effective dates for the various sections of the Tax Reform Act of 1969 as proposed therein.

For the convenience and fairness to taxpayers and donee institutions, all effective dates in the Tax Reform Act of 1969 should be the date of the final enactment of the law. Gifts made prior to that date should not be affected by any type of retroactivity. Philanthropy has already been adversely affected by the confusion of the proposed effective dates. Provisions of the law should be prospective in application and should not disturb the gifts already established under gift agreements entered into prior to the effective date of enactment.

We oppose, in their present form, the provisions of the Tax Reform Act of 1969 which require the filing of annual returns.

Sec. 101 (d) of H.R. 13270 would require the filing of annual returns. With regard to such filing by privately supported colleges and universities, there is no basic objection. We encourage fair and efficient administration of the tax laws. However, we vigorously oppose the idea that information contained in such returns should be made public. We receive many anonymous gifts. The public disclosure of such a donor's name would require the college to break an article of trust between it and the donor. Additionally, the disclosure of the salaries paid to faculty and others would break a long-standing principle of confidentiality regarding these matters. As far as colleges and universities are concerned, we see no worthwhile objectives to be gained by such disclosures. In our opinion, there has been no abuse in gifts to colleges and universities to warrant disclosure of donor lists and salary schedules. Required information is already available in taxpayer returns. As to institutional returns, the basic doctrines regarding the right to privacy should prevail.

<u>We find the following matters of smaller direct significance, yet needful of revision:</u>

1. <u>Bargain Sales</u>.

   It is now doubtful that the proposed law would exclude the discounted cash value of a gift annuity contract as the bargain sale price of securities or real estate used to fund an annuity. The additional treatment of bargain sales to a charitable organization (Sec. 201 of H.R. 13270) should expressly exclude from its purview the gift annuity.

2. <u>Unrelated Debt-Financed Income</u>.

   Sec. 121 (d) of H.R. 13270 contains the commonly called "Clay-Brown" provisions. An obligation to pay an annuity is excluded from the definition of "Acquisition Indebtedness." This exclusion must be broadened so that it applies to the contractual obligation of an institution to pay to a donor the income from property under a life income agreement. So long as the life tenant continues to live, all income under such contracts is paid to the life beneficiary who then pays income tax thereon. The college acts solely as a conduit in its position as charitable remainderman. There should be no tax consequence to the college under these circumstances.

EXHIBIT 1-A

BELOIT
CARLETON
COE
COLORADO
CORNELL
GRINNELL
KNOX
LAWRENCE
MACALESTER
MONMOUTH
RIPON
ST. OLAF

1969 1970 ACM Academic and Service Programs

THE ASSOCIATED COLLEGES OF THE MIDWEST

OTHER PROGRAMS

ACM faculty members are encouraged to pursue study and research into the cultures and civilizations of Asia, Africa, the Middle East, Latin America, Eastern Europe, and the Soviet Union through **The Non-Western Studies Program**. The three major aspects of this program are: provision of grants for faculty study and research, seminars; and the strengthening of library holdings.

Through **The Science Education Study**, ACM is making a comprehensive summation of practices, developments, and trends in science teaching at its colleges. It will investigate innovations in curricula and teaching technique; it will seek to determine science faculty problems.

Through **Institutional Research** ACM seeks to know more about its students, alumni, faculties and facilities at all twelve colleges. As systematic data collection increases, answers to many questions—from cost analysis to the impact of the college on the student—will be possible.

The Video Tape Program has made available almost 400 hours of unrehearsed and spontaneous classroom activity for use in teacher education. For the teacher trainee this program is an invaluable aid in filling the gap between academic theory and actual practice. Student-teachers have the opportunity to see and learn by actual observations of different teaching-learning situations.

The Washington, D.C. Office is maintained to interpret the nation's capitol and federal activity to our colleges and its programs. The director of this office provides us with reports from the Washington scene and expedites ACM and member college proposals. She provides administrative services for ACM staff and faculty in Washington.

THE URBAN STUDIES PROGRAM

This program gives the student academic and first-hand knowledge of many of the monumental problems of the city: its politics, economics, and racial strife; its metropolitan, suburban, and inner city dilemmas, its problems of city planning, urban renewal, and educational development; its crises in transportation, pollution, crime and delinquency. The students live in the city against the background of Chicago's rich cultural resources, landmark architecture, and museums. Formal class work includes the Core Course, an intensive examination of the city, the Seminar on "Power and Justice"; and an individual study project. Each student also works part time in a social agency, community organization, business firm, or government office.

Length of Program: One semester.
Prerequisites: Students who will be sophomores, juniors, or seniors may apply.

THE URBAN TEACHING PROGRAM

Conducted in cooperation with the Chicago Public School System, this program gives ACM undergraduates the opportunity to student-teach in inner city schools and to study in seminars concerned with the education and sociology of an urban environment. The Urban Teaching Program provides the student with two teaching experiences, to permit contrasts between socio-economic levels of student populations, and ethnic origins of school neighborhoods. In addition to the teaching program, the student is involved in two seminars in Urban Education and Urban Sociology. These include field trips, lectures by urban specialists, and discussions with visiting scholars.

Length of Program: Fall or spring semester, or winter quarter.
Prerequisites: The usual for practice-teaching.

ARTS AND HUMANITIES

THE NEWBERRY LIBRARY SEMINAR

Advanced students in the humanities join a community of scholars in the humanities as "Student Fellows". They live in Chicago and study at Newberry, one of America's great research libraries, the holdings of which include some 850,000 volumes and more than four million manuscripts in the history, literature, philosophy and music of Western civilization from the Middle Ages to the present. Each year the Seminar is devoted to a selected historical period, in 1969-70 it is the Renaissance. Students meet with other scholars and faculty members carrying on research at the Library to discuss their research activities. The students work with close guidance from two ACM faculty members.

Length of Program One semester
Prerequisites Working background in history or literature; junior or senior status

THE NEW YORK ARTS PROGRAM

An apprenticeship with an individual artist or in an arts organization forms the core of this program originated by the Great Lakes Colleges Association. Students live in New York City and view the visual and performing arts in this great art center. Participants will have ready access to a vast number of original works of art, to a variety of dramatic and musical events, and to special research collections. A weekly seminar focuses on exhibits, performances, and collections which the students have viewed during the week. A student may elect a supervised independent study project. Each student is individually placed in his apprenticeship, where he may expect to spend twelve or more hours weekly.

Length of Program: One quarter or one semester.
Prerequisites: Most students will be upperclass majors in the arts, although this is not required.

THE INDIA STUDIES PROGRAM

Students participating in this program are exposed to the culture, the contemporary issues, the social strata, and the political parties of India. Participants receive their initial training in India Studies during a quarter spent at Carleton College. They then travel to Deccan College in Poona, India, a cultural and educational center about 120 miles from Bombay. While living abroad each student continues his language instruction in the Marathi dialect, pursues an independent research project, and participates in a seminar. In the course of the seminar, students will meet with politicians, academicians, and local officials. Students will have the opportunity to travel to other areas of India during their study there.

Length of Program. Nine months
Prerequisites. All students enrolled at ACM colleges are eligible.

THE ARABIC STUDIES PROGRAM

Students with an interest in the history, culture, and contemporary events of Egypt and the Middle East study for one or more semesters at the American University in Cairo. The formal curriculum includes a Core Course in Modern Abrabic Studies, History of the Middle East, Colloquial Arabic, and two elective courses. ACM students live in university quarters with others in the AUC student body. A series of field trips and meetings with local experts acquaint the student with the people and the cultural background of his immediate environment—Cairo, and Egypt. Students are encouraged to spend two semesters at AUC since one semester will give them only a broad overview of this vast field of study.

Length of Program One or two semesters.
Prerequisites. Students who will be sophomores, juniors, or seniors at ACM colleges may apply.

THE CUTTINGTON COLLEGE PROGRAM

A small, private, coeducational, liberal arts college on the western coast of Africa (in Liberia) provides the setting for one of ACM's most unusual programs. Recent graduates and faculty of ACM colleges teach students from many African countries. In addition to their teaching responsibilities, faculty and ACM graduates frequently do research, advise and carry on administrative duties. Participants receive a stipend and termination allowance for their work in much the same manner as Peace Corps volunteers. Cuttington has a student population of 250. Its graduates serve as teachers and principals in Liberia's growing elementary and secondary schools, as nurses, and in important governmental and business positions.

Length of Program: Two years for ACM graduates, one year for faculty
Prerequisites: College graduation or faculty status

CENTRAL AMERICAN FIELD STUDIES

This program offers undergraduate students the opportunity to make an interdisciplinary study of the rural tropical society of Costa Rica. Research teams consisting of faculty members and students carry out investigations of social and biological problems. Topics may include the problems of tropical food production, a study of rural political activity, international trade relating to agriculture, and Mesoamerican archaeology, including excavation at a selected site in Costa Rica. The main headquarters for the program are in San Jose, although students normally spend considerable time in the field.

Length of Program: Usually five and one-half months
Prerequisites: Completion of two years of college work, knowledge of Spanish language recommended

THE PERIODICAL BANK

Located at ACM headquarters in Chicago, the Periodical Bank contains backfiles of 1,500 scholarly journals and periodicals, as many as possible in microform. The service provides a paper-print out of microform holdings which is put in the mail on the day the request is received via teletypewriter at the Bank. The journal availability of each of our libraries is thereby considerably extended. The Bank is an effort to resolve cooperatively a common problem which none of our ACM libraries is able to accomplish satisfactorily on its own: the unpredictable needs of current and changing programs in the face of proliferating knowledge, publications, and student individual study programs.

THE SINGLE APPLICATION METHOD (SAM)

Students interested in being considered for admission at more than one ACM college may take advantage of this unique admission procedure. The student files only one application with his first choice college, his secondary school provides only one copy of his high school transcript and record form, and he pays only one application fee. If the student is not accepted by his first choice college (in past years nearly 70 per cent of SAM applicants were), his application is immediately forwarded to the admissions office of his second choice college, and so on. SAM is recommended only for candidates who are prepared to state which of the ACM colleges is his first choice and to list other colleges in order of preference.

SCIENCE

INTRODUCTORY GEOLOGY IN THE ROCKY MOUNTAINS

To unravel the geologic history of the area around Bozeman Montana that is the goal of students participating in this program in cooperation with Montana State University Students are introduced to geology in a field setting which stretches from the Tetons to Glacier, and from the Crazy Mountains to the Craters of the Moon Students spend about three days a week in the field Three trips of about four days each are taken during the summer program Participants live in campus facilities and use Montana State geology lecture rooms and laboratory facilities

Length of Program Eight weeks
Prerequisites High school graduation and admission to an ACM college or completion of one year at an ACM college

THE WILDERNESS FIELD STATION

Students interested in pursuing independent study in science live and work in the Boundary Waters Canoe Country of northern Minnesota, twenty miles from the nearest road Operating from a base camp, students of botany, zoology, aquatic biology, and geology explore the wilderness region by foot and canoe, learn basic techniques of field research and carry on individual study projects The field station is located on Basswood Lake an area containing a great variety of plant life, over 700 distinct species have been collected Zoology students have experiences in trapping, in bird observation and in preparing mammal specimens The lakes are rich in aquatic flora and invertebrate fauna and regional rock types are varied in this area

Length of Program Five or nine weeks in the summer
Prerequisites At least an elementary course in the discipline to be studied

THE ARGONNE SEMESTER

Students majoring in biology chemistry, geology or physics study in a research oriented environment and assist research scientists on the staff of the Argonne National Laboratory located 25 miles southwest of Chicago The Argonne Semester makes it possible for undergraduates to work with scientists who are doing research on current problems using the most modern scientific instruments The student spends about one quarter of his time working in a disciplinary seminar in biology, chemistry, or physics, one quarter time working in an interdisciplinary seminar, and about one half time working on his own research project as a student aide to a research scientist ACM students are housed together in facilities on the laboratory site

Length of Program Students, six months, faculty, fifteen months
Prerequisites Junior or senior status, majoring in a science

ARTS AND HUMANITIES

CHILDREN'S THEATRE AND CREATIVE DRAMATICS

Students interested in speech, drama, acting and directing and in producing and writing plays for children, work and study in a unique educational theatre program in Evanston, Illinois The semester-long program has five components: two courses in Children's Theatre and Creative Drama, a practicum internship in "Theatre 65 of Evanston", a children's theatre, a practicum serving as a teacher aide to a creative dramatics teacher in the Evanston public school system's elementary and junior high schools, the preparation and touring of scenes from plays, and the seminar, which includes an independent study project This program serves as excellent preparation for teaching dramatics or working with children in community centers youth groups or settlement houses

Length of Program One semester
Prerequisites All students enrolled at ACM colleges are eligible

THE GREAT LAKES COLLEGES ASSOCIATION

Incorporated in 1961, the Great Lakes Colleges Association remains composed of its twelve charter members. Albion, Antioch, Denison, DePauw, Earlham, Hope, Kalamazoo, Kenyon, Oberlin, Ohio Wesleyan, Wabash, and the College of Wooster. Located in three states, varying in size, and manifesting diverse campus tones, the member institutions nevertheless share qualities which have made their collaboration especially fruitful. Each is fully committed to quality undergraduate education in the liberal arts, each believes in the value of the comparatively small, cohesive academic community; each is open to forms of experimentation and innovation which will wed the enduring and traditional values of the liberal arts tradition to patterns of education which will have meaning and impact in these revolutionary times. And each accepts the axiom that associative activities can and do provide educational opportunities for faculty and students that the members cannot provide singly.

The Association has developed and now administers international education programs in Africa, Colombia, India, Lebanon, Japan, and Yugoslavia. There is a GLCA Arts Program in New York City and an Urban Semester in Philadelphia. In the summers of 1968 and 1969, GLCA and the University of California at Santa Barbara administered an NSF supported program in marine biology at Santa Barbara. Further, GLCA has standing committees on teaching and learning, the sciences, the humanities, and aspects of administrative cooperation.

The presidents of the twelve member institutions comprise the GLCA Board of Directors. The Association's fiscal support comes from annual assessments of the member institutions and from grants. The assessments provide for the GLCA Central Staff, located at the Detroit Metropolitan Airport, Inkster, Michigan. A portion of the assessments is also used to develop projects and conduct special investigations. Grants from federal and private sources have and are continuing to support special projects.

The GLCA Central Staff is composed of:

Henry A. Acres, President
A. Paul Bradley, Assistant to the President
Mrs. Eve Moulso, Executive Secretary
Mrs. Billie Cuddeback, Secretary

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EXHIBIT 2

While educational achievement and contribution to the national welfare are measured by many indices, the following statistics indicate the heavy impact of the colleges in the Associated Colleges of the Midwest (A.C.M.) and in the Great Lakes Colleges Association (G.L.C.A.). This impact is fostered by the voluntary support of private philanthropy.

I
PRODUCTION OF M.D. DEGREES

Of the 100 undergraduate colleges having the highest percentage of male graduates receiving M.D. degrees from 1950-59, we find A.C.M. and G.L.C.A. having nine institutions represented. Three were in the top 50.[1]

II
PRODUCTION OF COLLEGE TEACHERS

Turning to the production of college teachers, we find A.C.M. and G.L.C.A. colleges effective in proportion far beyond their numbers. In a study of 17,749 faculty members[2], 14 A.C.M. and G.L.C.A. colleges were among the top 50 institutions in the number of college teachers produced per 1,000 full-time undergraduates.

This study also pointed out that of 14,550 college teachers surveyed, 30.8 per cent received their undergraduate degrees at private institutions.

III
PRODUCTION OF Ph.D. DEGREES IN SCIENCE

The A.C.M. and G.L.C.A. colleges know themselves as comparatively smaller, privately supported institutions.

[1]William A. Manuel and Marion E. Altenderter, Baccalaureate Origins of 1950-1959 Medical Graduates. Public Health Monograph No. 66 (Washington: U. S. Government Printing Office, 1961), pp. 18-19.

[2]Allan O. Pfnister, A Report on the Baccalaureate Origins of College Faculties (Washington: Association of American Colleges, 1961), pp. 30-31.

Yet, the production of scholars among their graduates is comparatively very high.

Looking at 6 G.L.C.A colleges in Ohio[1] during the period 1960-66, we find 352 of their baccalaureate degree graduates receiving the Ph.D. in Science (Biology, Chemistry, Physics, and Mathematics) The average combined enrollment of these six colleges totaled 11,003 annually.

During the same period three larger universities[2] having an average combined enrollment of 56,688 annually, produced 302 baccalaureates who received the Ph.D. in the above sciences.

IV
PRODUCTION OF SEMINARY STUDENTS

In a Lilly Endowment study[3] of pre-seminary education, excluding Roman Catholic seminarians, privately supported institutions produced 75% of seminary students enrolled in 1960-61. One A.C.M. college ranked in the top 15 of such institutions.

V
PRODUCTION OF WOODROW WILSON FELLOWS

Without regard to the number of students enrolled and without regard to source of control (public or private), there were 12 A.C.M. and G.L.C.A. colleges among those 65 colleges and universities having 10 or more graduates elected Woodrow Wilson Fellows in the period 1945-60.[4]

[1] Antioch, Denison, Kenyon, Ohio Wesleyan, Oberlin, Wooster.

[2] Ohio State University, Ohio University, University of Miami (Ohio).

[3] Keith R. Bridston and Dwight W. Culver, Pre-Seminary Education (Minneapolis: Augsburg Publishing House, 1965), p. 204.

[4] Data tabulated from Directory of Fellowship Awards for the Academic Years 1945/46-1960/61 (Princeton, New Jersey: Woodrow Wilson National Fellowship Foundation, 1960), pp. 476-83.

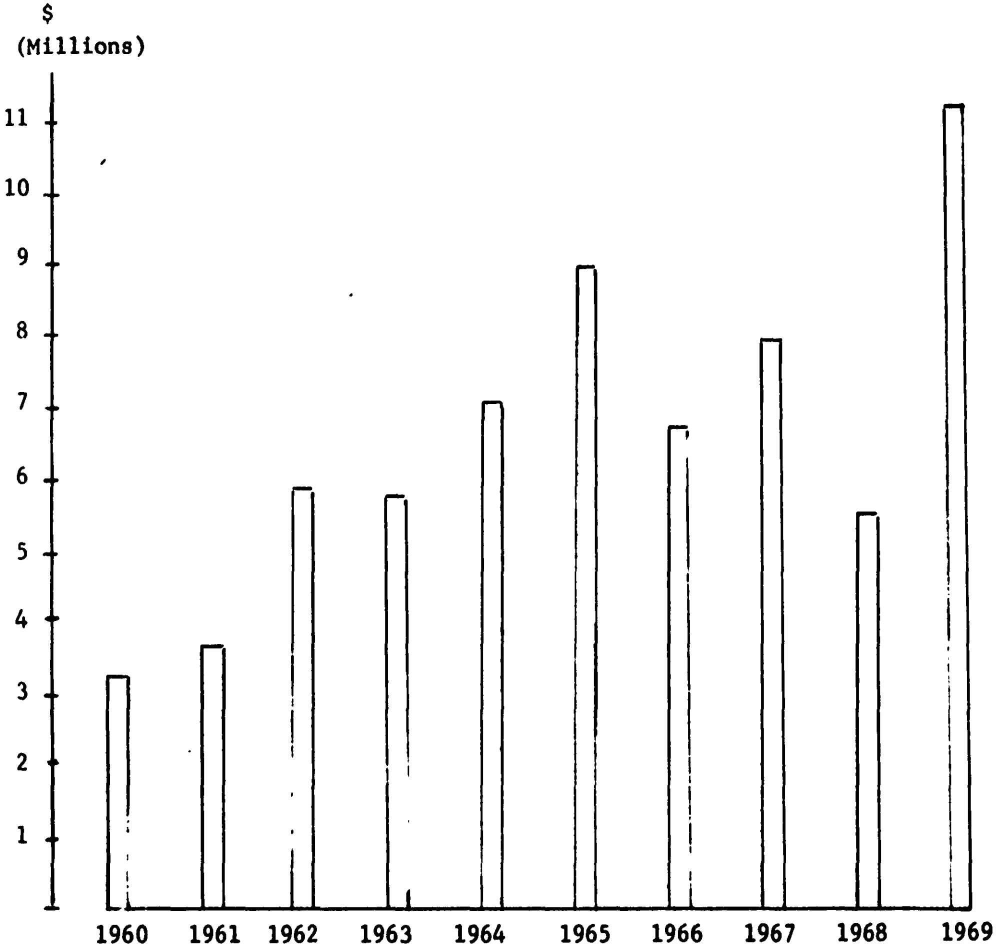
VI
PRODUCTION OF DANFORTH FELLOWS

Again, without regard to the number of students enrolled and without regard to source of control, there were 12 A.C.M. and G.L.C.A. colleges among those 53 colleges and universities having 5 or more graduates elected Danforth Fellows in the period 1952-62.[1]

[1] Data tabulated from The Annual Report of the Danford Foundation, 1961-62 (St. Louis: The Foundation, 1962), pp. 25-66.

EXHIBIT 3

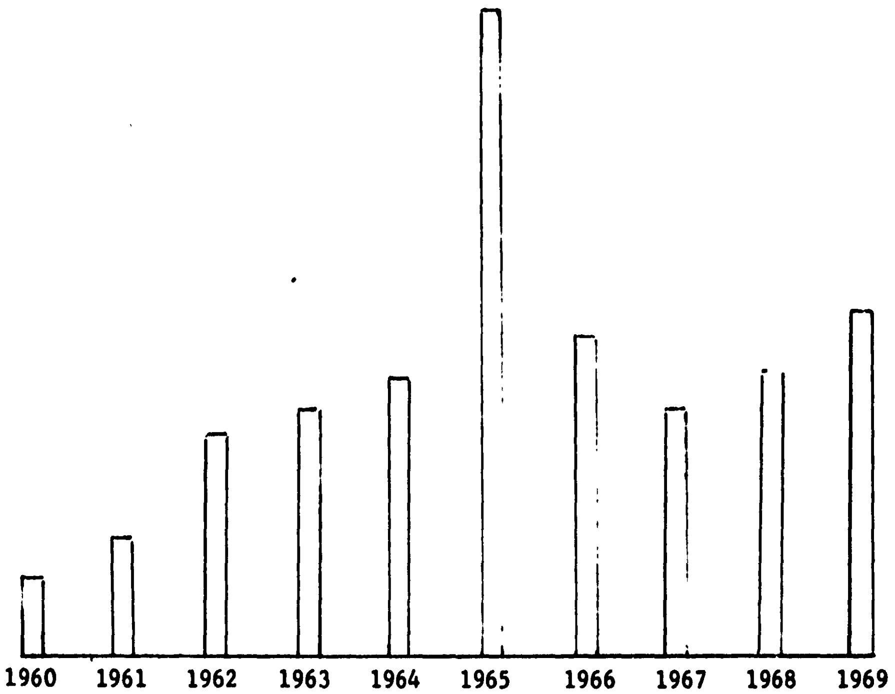
VALUE OF GIFTS OF APPRECIATED PROPERTY
TO A.C.M. AND G.L.C.A. COLLEGES
1960 - 1969[1]



[1] Total value of gifts of appreciated property for the ten-year period: $ 66,610,000.

EXHIBIT 4

VALUE OF FUTURE INTEREST GIFTS RECEIVED BY A.C.M. AND G.L.C.A. COLLEGES 1960-1969[1]



Total value of future interest gifts received during the ten-year period: $19,572,000.

VASSAR COLLEGE
POUGHKEEPSIE · NEW YORK 12601
Office of the President

STATEMENT CONCERNING H.R. 13270

To the Honorable Russell B. Long, Chairman
Committee on Finance, United States Senate:

My name is Alan Simpson, and it is as the President of Vassar College in Poughkeepsie, New York, that I make this statement to you and to the other members of the Senate Finance Committee on the deleterious effects H.R. 13270 would have on the financial operation of our college.

Vassar College, a private, non-denominational, four-year fully accredited liberal arts college, is financially supported by and dependent upon student tuition and income from charitable contributions. During the 1968-69 fiscal year, income from endowments established by earlier charitable contributions amounted to $997 per student, and current outright gifts made to the college were $435 per student. Thus, total income from charitable contributions was $1,432 per student or 37.2 percent of the total income received by the institution.

These gifts were used for current general operating expenses, including the operations of academic departments and scholarships and other student aid. I want to emphasize that 33 percent of Vassar students require some financial aid, and a large percentage of this necessary aid comes from charitable contributions from alumnae and friends of the college.

During that same fiscal year, 1968-69, Vassar received gifts from private sources totaling $3,965,525. Included in this total were 181 gifts of securities with a market value of $1,424,918, which is 36 percent of the total. Gifts in the form of annuities and life income contracts amounted to $575,052 of which $426,355, or 74 percent, were gifts in the form of securities. At the present time, we have 669 life income contracts and annuities on our books, with a total book value of $4,973,407. Obviously this type of deferred giving is particularly appealing to our alumnae since it assures them of income during the remaining years of their lives and then makes it possible for their Alma Mater to benefit from their personal generosity upon their death.

Despite this kind of generosity over the past years, Vassar College now finds it essential to embark upon a major effort to raise $50,000,000 to help meet ever-increasing operating expenses and to provide for long deferred plant rehabilitation and for sorely needed additional scholarship funds. The ravages of inflation on the college are best demonstrated by the fact that although Vassar had a balanced condition in 1967-68 and only a minor deficit in 1966-67, our operating deficit for the past year was $1,289,000. Our long-range projections show annual estimated deficits of well over $1,500,000, without the additional support from charitable contributions expected from our new fund drive.

Clearly, then, our financial problems are severe and growing. Any tax legislation that discourages gifts of securities with appreciated values will only make our fund-raising efforts more difficult. Moreover, removing many of the tax benefits from life income contracts and seriously reducing the tax benefits of annuities would be another severe blow to our college. As I have said, such forms of giving are highly favored by those of our alumnae who need life-time income but also hold their college in such high regard that they wish it to receive their financial stake after they no longer require it.

I should like to close this statement with a formal request to you that our present tax laws be amended in such a way as to keep the avenues for charitable contributions for support of education simple, clear and forthright. Such private support is chiefly for the benefit of the students of today and of the future. To remove or seriously alter the tax benefits of such contributions will only make private institutions dependent upon the support of the State and the Federal Governments. In the end, education will suffer, and the burdens upon the ordinary taxpayer over the long run will be increased.

Respectfully submitted,

Alan Simpson
President

September 13, 1969

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SECURITY BUILDING
PHOENIX, ARIZONA 85004
602 252-3011

September 12, 1969

Senator Paul Fannin
Room 140, Senate Office Building
Washington, D.C. 20510

Re: Relationship of proposed changes in Federal Income Taxes to small museums

Dear Senator Fannin:

On behalf of the two Phoenix Museums (the Phoenix Art Museum and the Heard Museum of Anthropology and Indian Art), I want to express serious concern over two proposed changes in Federal Income Tax laws as they relate to small museums. Those changes are: (1) the 7 1/2% tax on a museum's investment income and, even more importantly, (2) the application of the income tax to gifts to museums.

SUMMARY:

The effect, especially of proposal (2), will be to keep the great art and anthropological treasures of our culture in private hands and away from the public, and, to seriously cripple or prevent the growth of the collections of smaller museums.

To understand why these results are inevitable, there are a few MUSEUM FACTS and a few TAX FACTS which must be understood .

MUSEUM FACTS:

1. The Phoenix Art Museum operates on a total budget of less than $200,000 a year and the Heard Museum of Anthropology and Indian Art operates on a total budget of less than $100,000 a year. In both cases, most of the budget

goes for salaries and maintenance. In neither case are there more than pennies (if any) for acquisitions. I understand this to be the situation existing in most small museums in the country.

2. The budgets for our two Museums are raised by small contributions averaging less than $50 apiece from private citizens in the Phoenix area.

3. Rarely can small museums afford to make significant additions to their collections by purchase. Thus, over 98% in value of the present collections of both Phoenix museums is the result of gifts from private donors. If these collections are to grow, this same pattern (gifts) will have to continue in the future.

4. Both museums are attempting to build endowment funds which will generate some operating monies for future years. At this point both funds are small and the income therefrom is minuscule.

TAX FACTS:

5. Under present tax laws, if you purchased an Andrew Wyeth painting many years ago for $10,000 now worth $40,000 and chose to give it to the Phoenix Art Museum, you could get a $40,000 tax deduction as the result of your gift.

6. Under the proposed tax laws, you would have three choices:

(a) You could give the painting to the Phoenix Art Museum deducting only your cost of $10,000 and pay no tax. Thus you would lose the benefit of $30,000 of appreciated value.

(b) You could give the painting to the Phoenix Art Museum taking a charitable deduction for its true market value of $40,000, but, the $30,000 increase in value would be added to your income for income tax purposes.

(c) You could will the painting to the Museum or to a relative or friend. If you took the latter course, after you died, the relative or friend would acquire the painting by inheritance at its market value ($40,000). The relative or friend could then give the painting to the Phoenix Art Museum, take the full $40,000 charitable deduction and pay no tax.

From the Museum's point of view and from the point of view of the public who would like to see that painting, the unfortunate result is that the gift at least would be delayed and, perhaps, might never be made.

7. Under present tax laws, if many years ago you purchased a block of Valley Bank stock for $10,000 which today is worth $40,000 and you would like to give it to the Museum, you could take a $40,000 charitable deduction and pay no tax on the appreciated value of the stock.

8. Under proposed tax laws, you could still make the gift and take the deduction and suffer no tax consequences, provided at least 50% of your income was subject to taxation. In computing the 50%, however, the $30,000 appreciation in that stock would be considered as income. Again, however, you could will that stock to the Museum or to a relative or friend. And, in the latter event, that relative or friend would inherit the stock at its true market value ($40,000) and would be able to make the gift to the Museum, taking the full $40,000 deduction and paying no tax.

Once again, the result is obvious, and, from the point of view of small museums, disastrous. The gift, at least, will be postponed, and, may never be made.

CONCLUSION:

Under the proposed revisions, the owner of art or stock still could take advantage of the appreciated value without changed tax consequences. But, to do so, his gifts to museums either would be seriously delayed (until his death),or, perhaps,

never made. It will be the museums, and, therefore, the public who will suffer.

It is respectfully submitted that this is not a reasonable approach.

Sincerely,

Edward Jacobson

Edward Jacobson

EJ/lh

SENATE FINANCE COMMITTEE

TAX REFORM BILL OF 1969 - HR 13270

Statement by Howard W. Johnson
President, Massachusetts Institute of Technology

Provisions Relating to Charitable Deductions

SUMMARY

I. Bill as written will inevitably have an adverse impact on future financial support of educational institutions.

A. Private philanthropy's share of roughly one-half of the total of support of educational institutions will be impossible to meet if Bill is enacted in its present form.

B. We believe it is possible to meet the objectives of the Bill (curbing of abuses) without the damage to genuine charitable giving which would be caused by withdrawing tax incentives and imposing penalties.

II. Principal Provisions adversely affec[illegible] [illegible]tional support.

A. Treatment of appreciation of [illegible]ted property.

1. 30% limitation whereas 50% limit on other gifts - Limitation applied to total value rather than amount of appreciation.

2. Appreciation as tax preference - This, together with the provision for allocation of deductions automatically reduces incentive for charitable giving, and takes back deductions otherwise granted and makes intelligent planning for future gifts impossible.

3. Appreciation element not deductible in gifts of future interests unless theoretical gain taken into income.

B. Treatment of Charitable Remainder Trusts.

1. Income tax and gift tax deductions are disallowed and gains realized by trust are taxed unless trust qualifies as Annuity Trust or Unitrust - This, in effect, requires charitable remaindermen to guarantee return to life tenant irrespective of yield.

2. *Ex post facto* application to existing trusts would have effect of freezing portfolios or imposing gains tax, which will be borne by the charity, whereas no such tax would have been imposed under the law in effect when the trusts were created.

3. Life income contracts - Ambiguities in the bill which raise so many dangers may eliminate support from this source.

4. Estate tax - Imposes Annuity Trust and Unitrust Rules and retroactively applies rules preventing self dealing, etc., to existing trusts whose governing instruments cannot be changed.

III. Miscellaneous Provisions.

A. Private Foundations - Severe provisions will reduce the substantial support of educational institutions now being received from foundations.

B. Reporting requirements - Disclosure endangers anonymous gifts.

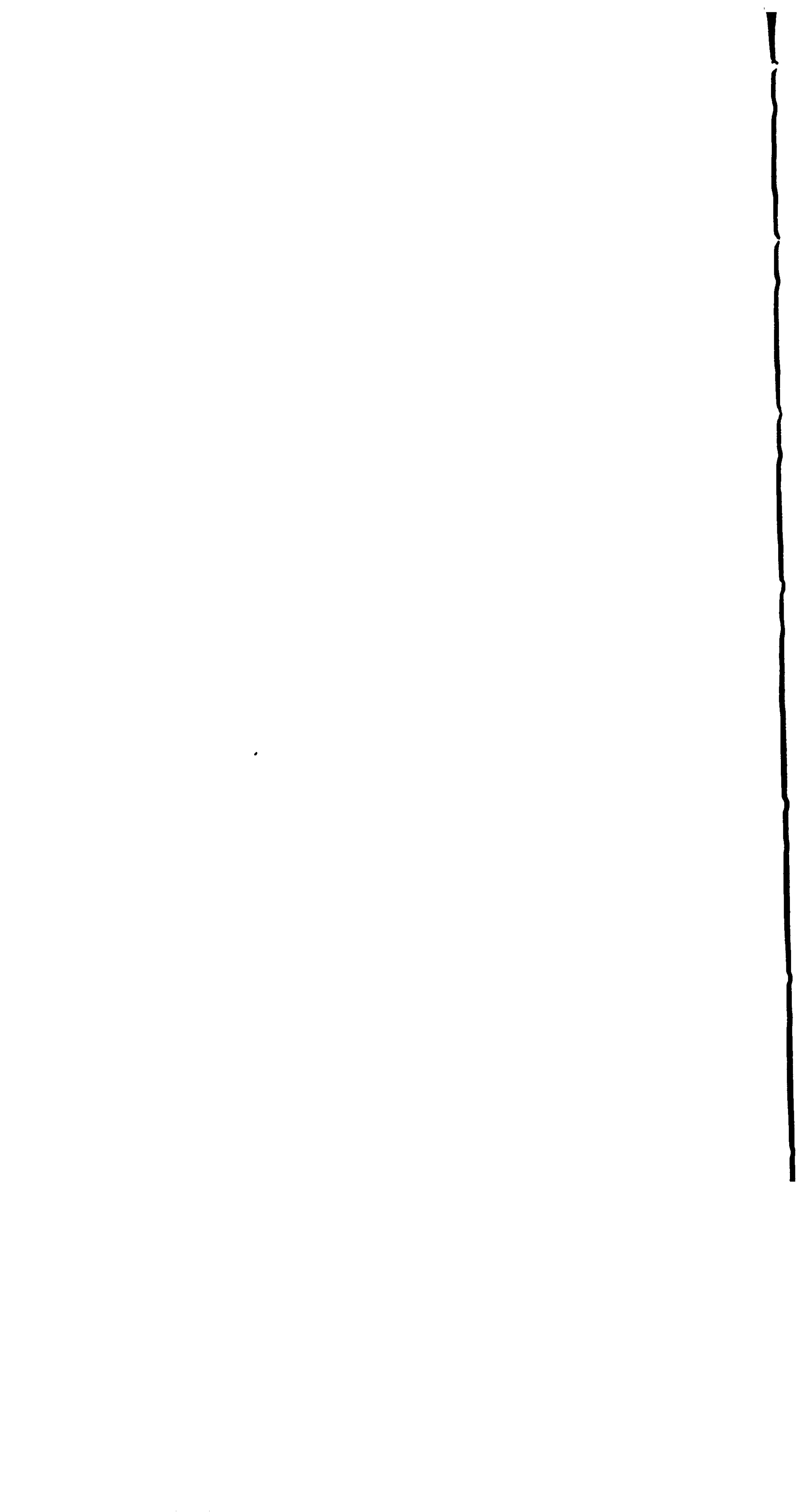
C. Unrelated Debt Financed Income - The Bill should exempt income from low income housing projects or at least exempt income from projects financed or insured by state or municipal authorities.

SENATE FINANCE COMMITTEE

TAX REFORM BILL OF 1969 - H. R. 13270

Statement of Howard W. Johnson*
on Provisions Relating to Charitable Deductions

* President of Massachusetts Institute of Technology



SENATE FINANCE COMMITTEE

Statement by Howard W. Johnson
on the Tax Reform Bill of 1969
(H. R. 13270)

Mr. Chairman and Members of the Committee:

My name is Howard W. Johnson, President of the Massachusetts Institute of Technology. It is a privilege to submit this statement and to join with many of my colleagues across the country in warning of the dangers of certain provisions of Bill H. R. 13270 which can be extremely hurtful to the future of higher education in the United States.

In commenting on these hurtful provisions, I want to make it clear that I do not stand in opposition to tax reform, and I recognize the formidable task the Congress faces in seeking to accomplish it. I recognize the need to curb tax abuses and to stop any subversion of laws designed to encourage philanthropic giving.

But cannot these objectives be reached without drastically discouraging private philanthropic giving? I think that they can; and I am convinced that they must if our private institutions are to secure the resources they need, not only to grow in strength but to survive.

I want first to underscore the urgency and magnitude of the current financial needs of our universities. Indeed, if you exclude the problem of finding a basis for a renewed spirit of concerned citizenship

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and involvement among the young, there is no problem facing higher education more critical than its financial one. As the head of a large private institution, I am keenly aware of the steadily rising cost per student and the mounting difficulties in finding adequate resources.

It should be especially clear that the flow of Federal dollars to educational institutions in recent years has not reduced the need for private funds in our private institutions. Private institutions will and do require both public and private funds, and those of us who have responsibilities for the financial integrity of private institutions have counted and planned on increasing amounts of gifts, grants and bequests from private sources. All our forward planning, which we have undertaken with great care, has been done on this basis.

The recent Report of the Carnegie Commission on Higher Education calls for private sources to support the same fraction of the total cost of education as in the past -- roughly half. The question before us is whether the private sector will be able to provide its share of the total cost which will rise from approximately $20 billion to more than $30 billion annually by 1976-77. To achieve this will be difficult under even favourable conditions; it will be impossible if we surround philanthropy with harsh constraints and regulations.

Looking at certain provisions of the Tax Reform Bill I am convinced that they are unwise and severely damaging to the future of all our

educational institutions. At this time when almost all institutions of higher learning are faced with mounting financial problems and towering capital needs, we must make sure to do all that we can to strengthen and not weaken the support given them to meet these needs and resolve these problems.

The provisions of the Bill which will have most serious and adverse effects on charitable giving -- aside from those provisions relating to private foundations, on which separate comment is to be presented to the Committee by my associate, Dr. James R. Killian, Jr., and others -- are (i) the treatment of donated appreciated property, particularly in conjunction with the allocation of deductions, and (ii) the provisions relating to charitable remainder trusts.

Due to the tax incentives afforded under the present law, a very substantial part of present charitable giving to private institutions is in the form of appreciated securities. At M.I.T., for example, nearly $31,000,000, or 27 per cent, of all donations received over the past four years have been in securities and approximately 38 per cent of gifts from individuals have been securities. We have no knowledge of the donors' cost basis, but it is a reasonable presumption that all these securities had significantly appreciated in value while held by the donors. The new law presents a clear danger to this important source of giving.

The allocation provision of the new law will also present a serious bar to charitable giving. If there is merit -- and, of course, there is -- to the policy of encouraging charitable contributions by affording deduc-

tions, it simply does not make sense to grant the deduction on the one hand and then limit or take it away with the other under the guise of an allocation. This is inconsistent with the policy which dictates the increasing of the limitation on charitable deductions to 50 per cent of the contribution base. It is inconsistent with the often reaffirmed policy of the Congress as it has evolved over a long period of time.

The Bill's treatment of Charitable Trusts poses an even greater threat and, because of its application to existing trusts, unjustly penalizes them. Charitable remainder trusts and life income plans have been and are a substantial source of contributions. At M.I.T., gifts over the past four years through charitable remainder trusts and life income plans have constituted in excess of six per cent of total contributions; and we had, before this Bill, expected this source of contributions to continue to grow. The Bill would sharply curtail or possibly eliminate future support from this source and would burden existing trusts at the expense of charitable remaindermen.

An equally severe blow to charitable giving would be dealt by the Bill's treatment of testamentary trusts and intervivos trusts, the property of which is includable in the taxable estate. Under present law, an estate is given a deduction for the remainder interest which goes to a charity. Such trusts and bequests are most important sources of contributions. Of total contributions received by M.I.T. from individual contributors over the past four years, about two-thirds was derived from these sources.

Clearly, we would be sorely hurt by this Bill, for the combined effects of the various sections relating to charitable trusts and bequests seriously limit deductions for gifts which can take effect only in the future. This strikes a very sensitive nerve in the make-up of private philanthropy because often the only feasible way a gift may be made is by providing that the charity will benefit only after the death of the donor and/or other persons to whom the donor has a prior responsibility. It is for this reason that such a substantial portion of giving has come through bequests and charitable remainders.

Let me turn now to a more specific and detailed examination of some of the particulars of the Bill. In view of the very wide scope and complexity of the Bill's "charitable provisions" (private foundations, unrelated income, charitable deductions, charitable remainders, tax preferences, allocation of deductions, etc.), I shall deal only with those aspects of these provisions that I deem most hurtful and troubling. I shall present not only a critique but make some suggestions for modifications.

GIFTS of APPRECIATED PROPERTY

The changes proposed by the Bill with respect to donated appreciated property which we find objectionable are:

1. 30% Limitation

   Whereas other gifts to qualifying charities would be subject only to a limitation of 50% of the "contribution base", the deduction for

gifts of appreciated property would be limited to 30% of such base. We feel that there is no necessity for this special limitation in the light of other provisions in the Bill which restrict the use and the abuse of the opportunity to make gifts of appreciated property, such as the provision Section 170 (e) (IRC) applicable to property, the disposition of which would result in ordinary income, the provisions relating to tangible property, etc.

Moreover, as written, this 30% limitation appears to apply to the full value of any gift of appreciated property regardless of the amount of appreciation. If the special 30% limitation is to remain in the Bill, it should certainly be applied only to the appreciation element and not to the entire value of the appreciated property. For example, a donor who gives property with a value of $50,000 and a cost to him of $40,000 should get no less tax benefit than one who makes a $40,000 cash gift. Nor should two donors who give property of equal present value be penalized to the same degree where the cost basis to one is $50 and to the other $50,000.

2. Gifts of Future Interests

No current income tax deduction would be allowed with respect to the amount of appreciation in property given as a future interest (as for example the remainder interest in a trust) unless the donor includes such appreciation in taxable income. In view of the other provisions relating to charitable trusts discussed below, we see no reason for this special limitation.

3. Appreciation as a Tax Preference

Among the tax preferences over which certain deductions must be allocated is the appreciation on any donated property. We recommend that at the very least such appreciation be eliminated as a tax preference for the purpose of allocating deductions (as in the case of certain tax-exempt interest). Otherwise the appreciation will have a serious effect in reducing the tax value to the contributor, not only of charitable deductions, but of most other deductions and will make it impossible for him to determine before the end of his

taxable year the true tax effect of his contribution. This factor is of real concern to substantial givers and would have a particularly adverse effect on extended pledges for contributions to be made over a period of years.

4. Charitable Gifts as Allocable Deductions

The allocation provision will present a serious hindrance to charitable giving. The effect of applying the allocation of deductions provision to the appreciation in charitable gifts of property as a tax preference must automatically reduce the tax benefit of charitable and other deductions even though the appreciation is the only tax preference which the taxpayer has. The greater the appreciation the more the deductions are decreased. If a taxpayer with $130,000 of gross taxable income donates securities having a fair market value of $40,000 and a cost of $10,000, a deduction of $40,000 would be allowed under present law. Under the Bill, the deduction would be prorated between taxable gross income and so-called tax preference income and would thus be reduced

by 13.3%.* Not only would this reduce the charitable deduction but the other deductions, which must also be prorated, would be reduced by the same percentage. Thus, though the taxpayer realizes no economic gain from the gift, the net effect would be a significant increase in his taxes.

Moreover, as noted above, because of its interrelation with the tax preferences, the donor will be unable to compute the tax effect of even a cash gift until the year end when the entire amount of his tax preferences (including such items as capital gains**) has been finally determined.

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* $$\frac{\$\ 30,000\ \text{(appreciation)} - \$10,000}{\$130,000\ \text{(gross income)} + \$20,000} = 13.3\%$$

** The capital gain is perhaps the most variable factor among the proposed tax preferences, the tax burden on which would be markedly increased by those provisions of the Bill which eliminate the alternative tax, and increase the holding period to twelve months. The treatment of the capital gain deduction as a tax preference imposes a real penalty by reducing other deductions and we submit that the donor should not be doubly penalized by a reduction in the charitable deduction.

CHARITABLE REMAINDER TRUSTS

Under the present law, a donor who creates a trust with income to himself and/or a member of his family for life and the remainder to charity, is entitled to a deduction for the discounted value of the charitable gift for income and gift tax purposes. Also, by virtue of Section 642 which affords a trust a deduction for amounts permanently set aside for charity, if the trust sells the corpus, the gain, if any, is not taxed since it is so set aside for charity. These charitable remainder trusts and life income plans (where the charitable institution is in effect the trustee) have been and are a substantial source of contributions.

The particular changes in this area which would be effected by the Bill are:

1. As noted above, no current income tax deduction will be allowed for the amount of appreciation in property given to such a trust unless the donor includes the appreciation in taxable income.
2. Intervivos gifts to such trusts would no longer qualify for a deduction to the grantor for income and gift tax purposes and the trusts themselves would be denied exempt treatment of gains realized by the trust, even though

clearly set aside for charity, unless the trust qualifies as an Annuity Trust (one which affords a guaranteed annual amount to the donor) or a "Unitrust" (one which pays to the donor or other life beneficiary, at least annually, a fixed percentage of the fair market value of the assets). The expressed reason for the new concept of the Annuity Trust and the Unitrust is to assure that the charity will ultimately receive its full remainder interest. In fact, the proposed provisions would have the opposite effect. Most existing trusts with charitable remainders provide for the income to be paid to the life beneficiary and the remainder to the charity. Under such trusts, the charitable remainderman bears the risk only of fluctuation in the value of the principal for the duration of the preceding life estate. Under the Bill, the charitable remainderman would bear not only that risk but also the risk of fluctuations in income from the property since it would, in effect, be guaranteeing payments not measured by the yield.

The charity could be required to use other revenues or even its capital to pay the life beneficiaries and, if the yield on the property declines from the rate used in computing the charitable deduction, the charity would net substantially less than it would under a trust created under current law.

By withdrawing the deduction for amounts permanently set aside for charity unless the trust meets the Annuity Trust or Unitrust requirements, the charity would now be presented with the unfortunate alternatives of either (i) guaranteeing a fixed return to the life beneficiary, potentially at a loss to the charity in the event that the fixed return exceeds the earnings, or fixing the rate of return so low as to be totally unattractive and thereby making it virtually impossible for the prospective donor to consider a gift, or (ii) bearing the cost of capital gain taxes in the event of a sale to diversify or otherwise improve the portfolio.

3. A very real inequity in these provisions results from their application to existing trusts.

Hereafter, deductions for amounts set aside for charity by an existing trust with a charitable remainder would no longer be available unless such amounts are currently paid out to the charity, which in many cases of existing trusts cannot be done under the governing instrument. Thus, though the trust was drawn under a law that gave it freedom from tax on gains, it would hereafter be taxed on the gain on the disposition of the property. The net result will be that either the portfolio will be frozen or the tax will be incurred, in which case it will be borne by the charity since the remainder will be reduced by the amount of the tax. We strongly urge that such tax not be applied to existing trusts.

At the very least, if the tax is to be given retroactive effect to existing trusts, the law should provide that the cost basis of the assets should be the fair market value of the property as of 12/31/69 (as the Bill provides in the case of certain private foundations) so that at least gains accrued to date will not be taxed. Unless that is done, the provision as it stands will

impose an additional undue burden on the charity or trust, as in most cases it will not have and cannot obtain records from which to ascertain the donor's basis so that it will likely be charged with a basis of zero.

4. One of the many complexities and ambiguities introduced by the Bill is its effect on life income contracts. Under a typical life income contract, the donor merely enters into a contractual arrangement with a university whereby, in exchange for a transfer of property, the university agrees to pay the donor for life or a term of years the income, either from the property or the appropriate percentage of income from a pooled fund in which this property is placed. Under the meaning of the Bill, is this a gift or a sale and, if it is a gift, is it a gift of a future interest?

If the transaction is a trust and a gift of a future interest, then (i) presumably the amount paid to the donor will have to conform to the so-called Annuity and Unitrust standards, i. e. the university would have to guarantee either a

certain amount or a certain rate of return irrespective of the actual yield, (ii) no current deduction would be allowed with respect to the amount of appreciation, if any, in the donated property unless the donor elected to include the appreciation in taxable income*, and (iii) the university as "trustee" would be liable for taxes on capital gains when and if the property were sold unless the arrangement met the Annuity and Unitrust rules.

If it is not a trust but an outright transfer or sale so that thereafter the property belongs to the university, then (i) does the donor realize a taxable capital gain on such sale, (ii) is it a so-called "bargain sale" so that the bargain sale provisions are applicable, and (iii) is it by chance "debt-financed" property so that income therefrom is unrelated income. The provisions dealing with unrelated income would appear to be sufficiently ambiguous and broad that they could include life income contracts.

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* If this is the result, the Bill would, as a practical matter, put an end to gifts made under life income contracts.

5. Not only does the Bill change the rules as to deductions of gifts to these trusts, but, under the heading of "Private Foundations", it would impose many of the same punitive taxes and regulations on trusts with charitable beneficiaries which are made applicable to private foundations. The 7-1/2% investment income tax and the "penalty" taxes (self-dealing, etc.) are imposed on those trusts which have only charitable beneficiaries and the "penalty" taxes are imposed on trusts in which only a portion of the beneficial interests are held by a charity. Like many other provisions of the Bill, some of these rules would be applied to trusts already in existence, even though the trusts were drawn (and in many cases cannot be changed) in reliance upon laws which afforded them freedom from such taxation and penalties.

As in the case of private foundations, the only apparent relief from these penalty taxes is under a provision Section 4947 which provides

that the Secretary "may", not "shall", abate the unpaid portion of a tax if the trust distributes all of its net assets to a specified type of charity.

6. Estate Tax Deductions

Under present law, an estate is given a deduction for a remainder interest which goes to charity. The proposed Bill would deny that charitable deduction in computing estate taxes for gifts or bequests in trust unless (i) the trust qualifies as an Annuity Trust or Unitrust, and (ii) the governing instrument expressly prevent self-dealing, speculative investments, etc.

These new estate tax rules are applied retroactively to intervivos charitable remainder trusts, the corpus of which is includable in the gross estate for estate tax purposes. Because of the incapacity of testators in some cases and because of the time that would be required to make the necessary changes of wills in practically all cases, many trusts under wills could not be changed to meet the requirements of the new law before death occurs. Also many intervivos trusts, the property of which is includable in the estate of the donor, cannot be changed because they were created under instruments which are irrevocable and unamendable. In such cases, though the bulk

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of the property will inevitably go to the charity, the estate will be denied the charitable deduction, even though such deduction was allowable under the law at the time that the instrument was executed. Again, the burden of this tax will fall on charity except in those cases where the governing instrument provides that the tax is to be borne by non-charitable beneficiaries, in which case it may very well wipe out such beneficiaries even though at the time the trust or will was drawn, the charitable remainder qualified for the charitable deduction.

At the very least, these provisions should be made inapplicable to existing trusts and testamentary trusts which cannot be amended and in addition the statute should extend ample time (perhaps one year after enactment) to permit appropriate changes in wills and trusts which can be amended.

7. Gift Tax Deduction

As noted above, the Bill would also disallow a deduction for gift tax purposes for remainder interests given to a charity except in those cases

where the charitable remainder qualifies as an Annuity Trust or Unitrust and the trust instrument expressly prevents certain acts (self-dealing, etc). This would present a major obstacle to charitable giving. The gift of a remainder interest in property is the most attractive way of making a charitable gift because it does not involve an immediate cash outlay. We believe, however, that there are few donors who could be persuaded to make such a gift if at the same time they were required to make substantial payments of gift taxes to the government, especially when such tax is occasioned by a gift which is irrevocably to go to charity.

MISCELLANEOUS PROVISIONS

Other provisions of the Bill which are of concern to educational institutions include:

1. Private Foundations

I understand that the many and complex provisions relating to Private Foundations will be commented upon in later testimony and I will, therefore, not deal with them here except to reiterate that institutions of higher learning, such as Massachusetts Institute of Technology, have in the recent past depended to a very substantial extent on contributions from such foundations. The proposed new taxes, particularly the punitive ones, which, if enacted, may well spell the end of such foundations, can only serve to reduce the much needed revenue that has been forthcoming from that source.

2. Reporting Requirements

Under the Bill all exempt organizations would be required to file certain returns and reports unless excused from so doing by the Commissioner of Internal Revenue if he determines

that such filing is not necessary to the efficient administration of the law. Included in the information required to be filed are the names and addresses of all substantial contributors. In addition, each contributor who transfers income-producing property having a value in excess of $50,000 must file a report of such transfer if the transferee is known by the contributor to be an organization which is subject to the tax on unrelated income.

We have no quarrel with an obligation to file reports that furnish information needed by the IRS to administer the law but we do not believe that such reports should require naming anonymous contributors. The filing and the publication of such information would place yet another hurdle in the path of charitable giving.

3. Unrelated Debt-Financed Income

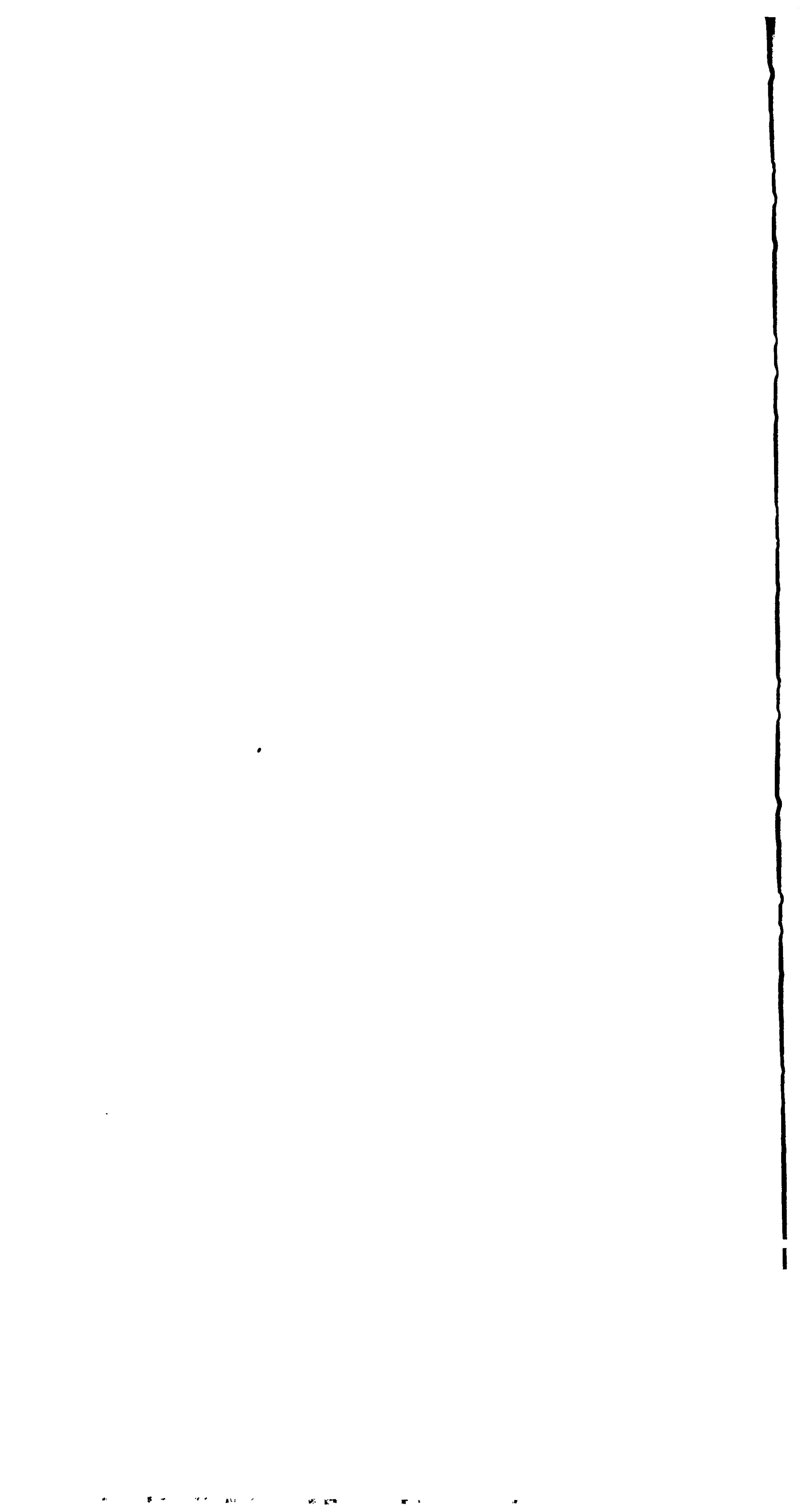
The Bill includes a provision which would subject income from certain debt-financed property to the tax on unrelated income (Section 514). Due to social pressures, a number of educational institutions, including Massachusetts Institute of Technology, are

inaugurating programs for the building of low-cost housing which can be financed only through debt. These projects will not be related directly to the institutions' educational function with the result that the only exemption accorded to this type of income is that debt obligations insured by the FHA are not taken into account in computing debt-financed income. In view of the need for low-cost housing and of the fact that the universities are obliged to undertake this as a pro bono publico matter, we suggest that the exemption should be broadened to include all debt-financed projects for construction of housing for low and moderate income groups. At the very least, the exemption should be broadened to include situations where the debt is insured by state or municipal authorities under arrangements similar to those with the FHA.

In sum, all the various items in the Bill which I have discussed impose very real obstacles to continued philanthropic support of education at a time when such support has become more necessary than ever to enable private institutions to meet their growing financial needs. I hope

most earnestly, therefore, that the Congress will give proper weight to this concern in its review of the proposed tax bill and seek to achieve a means of reaffirming strongly the traditional role of private philanthropy in our society within a framework of tax reform.

Howard W. Johnson, President
Massachusetts Institute of Technology



GARLAND JUNIOR COLLEGE
409 COMMONWEALTH AVENUE
BOSTON 15

OFFICE OF THE PRESIDENT

September 8, 1969

Honorable Russell B. Long, Chairman
Committee on Finance, United States Senate
2227 New Senate Office Building
Washington, D. C., 20510

Dear Senator Long,

The Trustees, the Faculty and the Administration of Garland Junior College in Boston wish to communicate to the Committee on Finance of the United States Senate their profound concern over certain provisions in the Tax Reform Act of 1969, H. R. 13270, as reported out by the Ways and Means Committee of the House, These provisions, if passed into law, would cut off the major sources of the private gifts that support so large a segment of higher education in this country. They would be a disastrous blow to Garland Junior College and to every institution in the nation, public as well as private.

Two provisions in the proposed act are the most damaging. They are:

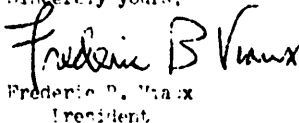
1) the imposition of new limitations on tax deductions for Gifts of Appreciated Property to qualified charities, and

2) the curtailment of tax deductions for Gifts of Remainder Interests - Life Income Contracts.

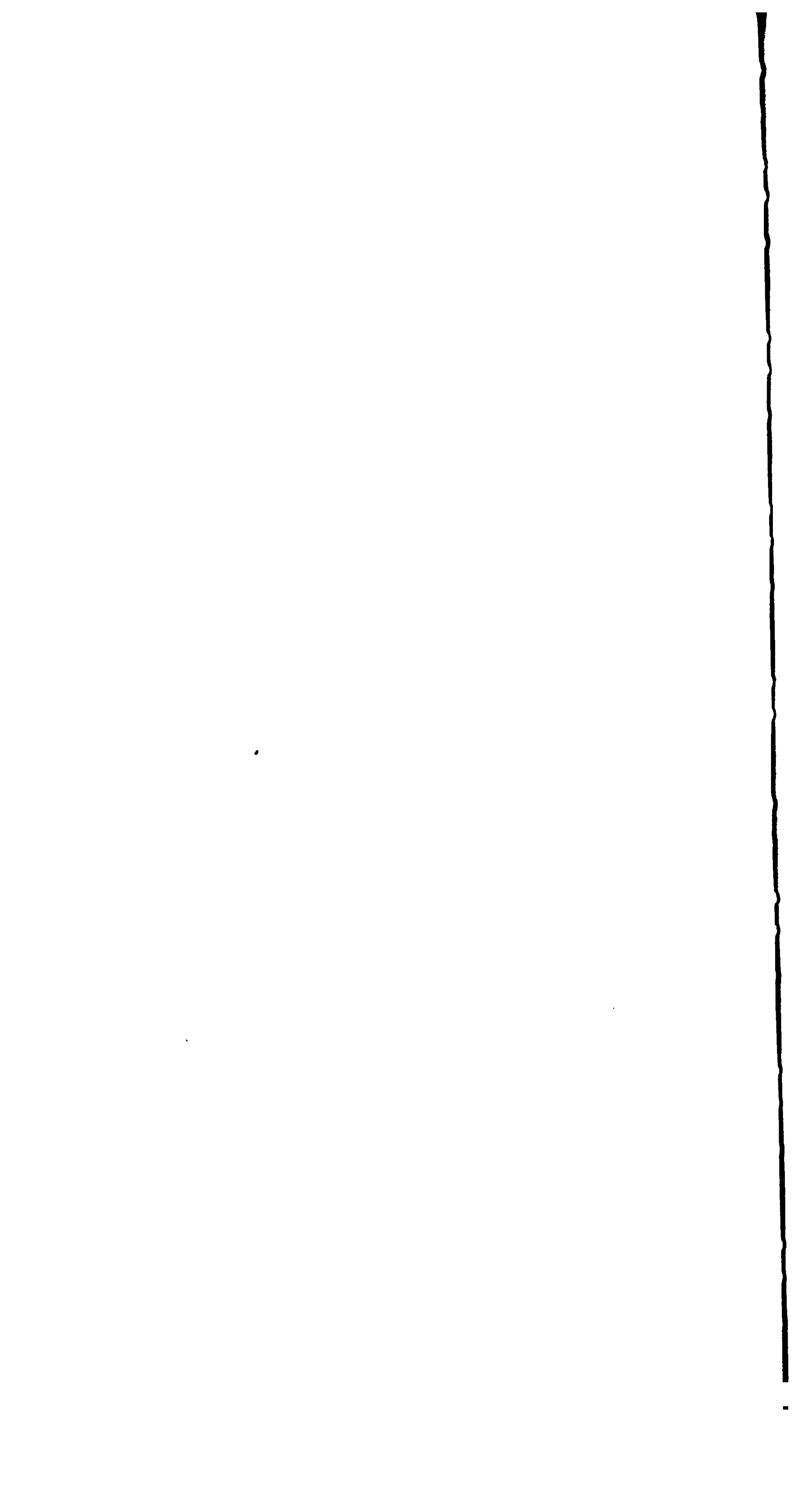
Gifts in these two categories are of vital importance to educational institutions, and we therefore urge the committee not to pass measures that will curtail them, but rather to encourage and facilitate them in every way.

While we fully appreciate and applaud the intention of the Congress to put an end to abuses of the tax laws, we reaffirm our faith in the thoroughly American way of private support for independent institutions and we believe it should continue unhampered. This system has given the United States the greatest universities and colleges in the world.

Sincerely yours,



Frederic B. Vinaux
President



SUMMARY OF STATEMENT ON TAX REFORM ACT OF 1969 BY THE ASSOCIATION OF INDEPENDENT CALIFORNIA COLLEGES AND UNIVERSITIES TO COMMITTEE ON FINANCE OF THE UNITED STATES SENATE*

The attached statement is submitted on behalf of the Association of Independent California Colleges and Universities. The Association represents the accredited four-year independent institutions of higher education in the State of California. Its member institutions educate more than one quarter of all California students in four-year and graduate programs.

The Association and its member institutions are deeply concerned with the grave consequences which would fall upon all independent , nonprofit educational institutions should the House-passed bill, H.R. 13270, be enacted into law without modification, for certain provisions presently provided therein would render a crippling, if not fatal, blow to all such institutions. These provisions are the ones which would erroneously classify certain charitable contributions as an item of tax preference for purposes both of limitation on such items and the allocation of deductions and also the ones which would seriously undermine the ability of the colleges and universities to obtain property subject to life estates.

* Submitted by Robert E. Burns, President.

Under the House-passed bill, a charitable contribution of appreciated property would be classified as a "tax preference" both for purposes of determining the limitation on such preferences and the allocation of deductions. Also, the personal deductions which are subject to allocation include a taxpayer's charitable contributions. The very complexities of these provisions would of themselves discourage gifts. Certainly, the provisions in present law and in the House-passed bill which place direct percentage limitations on charitable contributions impose an effective and efficient restriction thereon. For this reason alone, there is little justification for further limiting the deduction for charitable contributions by classifying gifts of appreciated property as a tax preference. Moreover, unlike the other tax preference items, a taxpayer realizes no economic benefit from making such a gift. In the case of a gift to charity, a taxpayer must bear a financial burden without the promise of a corresponding financial benefit. It is thus obvious that when a taxpayer approaches his ceiling on tax preferences, he will attempt to conduct his affairs in such a way as to avoid as much as possible the loss of any deduction, and that, of all the so-called tax preferences, the

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contribution of appreciated property to a charity will be the first which he will reduce or eliminate because it is the only one which promises him no financial benefit and will result in a cost to him in any event. Moreover, the inclusion of charitable gifts in the deductions which would be disallowed as a result of an allocation of deductions produces an even greater discrimination against charitable gifts because here, too, the taxpayer would often forego making such gifts in lieu of reducing or eliminating those items of tax preference which promise him financial reward.

There are several provisions in the House bill which would or could have an effect on gifts involving charitable remainder trusts, annuities, and life income contracts. Essentially, each of these three types of gifts allows a donor to make an immediate gift to a charity but retain an assured income for life. The importance of these gifts cannot be over-emphasized. In the case of many independent nonprofit educational institutions the annual value of these gifts represents 25 to 50% of the contributions which they receive each year. For these most important reasons, we ask the Committee to modify those provisions in the bill discussed below which would or could have an adverse effect on these three types of gifts:

(a) Subsection 121(d) of the bill should be clarified to make it inapplicable to income-producing property acquired by an exempt organization in exchange for a life income contract;

(b) Subsection 201(c) of the bill should be amended so as to make it inapplicable to gifts of future interests;

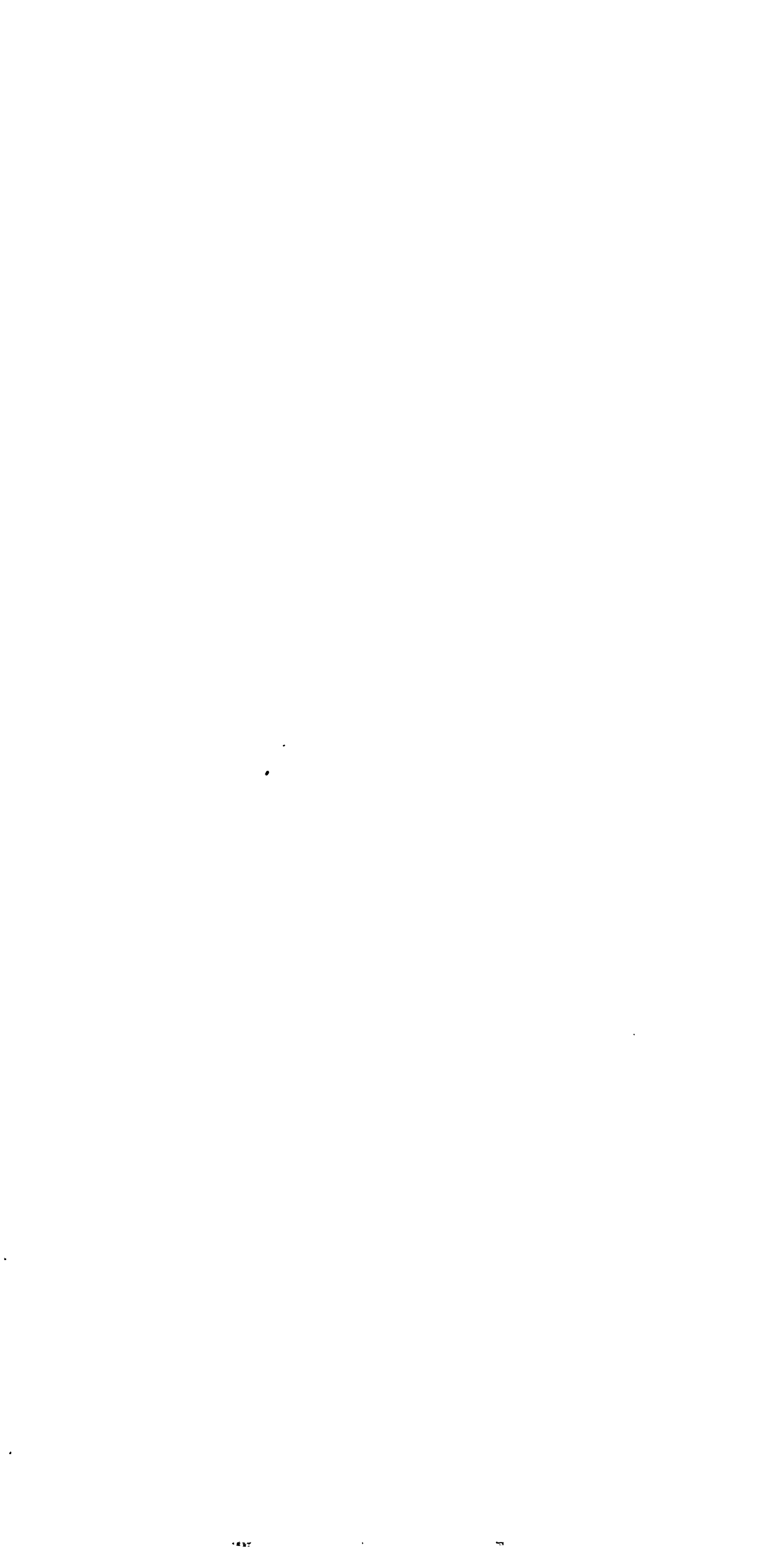
(c) Subsection 201(e) of the bill should be modified to be made clearly inapplicable to the three forms of gifts mentioned above;

(d) The concepts of "charitable remainder annuity trusts" and "charitable remainder unitrusts" should be removed from the bill by appropriate amendments to Subsections 201(e), (h), and (i) of the bill; and

(e) None of the provisions in the bill relating to charitable gifts should be made retroactive to a date prior to the date of enactment.

Since 1917 Congress has encouraged deductions for contributions to nonprofit educational organizations because it has recognized the significant and essential role which such organizations play in the continuing development of our society in this great nation. If the House bill is passed into law without the modifications requested above, Congress will discourage, and in

some cases completely eliminate, the very gifts which it has historically sought to encourage. We do not believe that upon reflection, Congress would desire such a result because it conflicts with its historic position and would deal a serious blow to higher education.



STATEMENT ON TAX REFORM ACT OF 1969
BY THE ASSOCIATION OF INDEPENDENT
CALIFORNIA COLLEGES AND UNIVERSITIES
TO COMMITTEE ON FINANCE OF THE UNITED
STATES SENATE

This statement is submitted on behalf of the Association of Independent California Colleges and Universities and each of its member institutions. It addresses itself to those provisions in the "Tax Reform Act of 1969," H.R. 13270, relating to the limitation on tax preferences, allocation of deductions and charitable contributions.

The Association of Independent California Colleges and Universities represents the accredited four-year independent institutions of higher education in the State of California. Its members range in size from small institutions with student enrollments of a few hundred, such as California Baptist and Dominican College of San Rafael, to such large institutions as Stanford University and University of Southern California with enrollments of over ten thousand. One great strength of this group lies in its diversity--not only in terms of size, but also in the ability of each institution to follow its particular philosophy of education, regardless of size. Thus, these institutions afford a richness of choice to students and play a major

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role in maintaining a pluralistic, decentralized and open society.

The member institutions of the Association educate more than one-quarter of all California students in four-year and graduate programs. This year they have enrolled 98,000 students and will award more than 10,000 undergraduate baccalaureate degrees and over 7,000 advanced degrees. Their graduates have gone on to contribute their diverse talents to all parts of our complex society, both public and private.

Such independent higher education does not mean exclusiveness. This year our members will be providing scholarship assistance to 25 per cent of their students and other financial assistance to an additional eight per cent. These independent institutions enroll a higher percentage of black students than do the four-year public institutions of California. This positive approach to the needs of underprivileged and minority groups evidences concern for critical social problems, willingness to become involved, and ability to adapt to such needs.

The Association and its member institutions hereby express their deep concern with the grave consequences which would fall upon all independent nonprofit educational institutions should the House-passed bill,

H.R. 13270, be enacted into law without modification, for certain provisions presently provided therein would render a crippling, if not fatal, blow to all such institutions. These provisions are the ones which would erroneously classify certain charitable contributions as an item of tax preference for purposes both of the limitation on such items and the allocation of deductions and also the ones which would seriously undermine the ability of the colleges and universities to obtain property subject to life estates.

In order for it to appreciate fully the serious threat which these provisions in the House bill pose to educational institutions, we believe that the Committee should be aware of the present and future financial needs and problems of our members.

Our members had total assets in excess of 1-1/2 billion dollars in the fiscal year 1966-67 and had educational budgets aggregating 211 million dollars. The sources of funds which satisfied the demands of these educational budgets for that year were:

Tuition and fees, 48%	$101,000,000
Private gifts and grants, 18%	38,000,000
Endowment income, 10%	21,000,000
Other sources, 24%	51,000,000
Total, 100%	$211,000,000

In addition to those budgetary operating expenditures,

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capital expenditures were made in the amount of $73 million during the same year. Thirty-three per cent of these capital expenditures were funded by private gifts. (Remaining sources were: Federal Government, 10%; Loans, 37%; and other sources, 20%.) If it were not for these private institutions and the private gifts which established and now support them, either the taxpaying public would have had to provide for these expenditures or the quantity and quality of education would have been greatly diminished.

The Association conducted a thorough analysis of the projected needs of its members for the ten-year period beginning with 1968 and ending with 1978. This study indicated that, because of expected increases in costs per student as well as in enrollments, the Association's members must add 10 to 12% each year to their incomes. In the absence of additional revenues beyond that which can presently be anticipated, the prospect is for income to fall increasingly short of operating requirements--by a total for all members of as much as $36 million by 1973 and $96 million by 1978. Actually, the need for increased operating revenues has already assumed considerable urgency. During the period 1957-1965, an average of four member institutions per year experienced operating deficits of more than $50 per

full-time student. Eight institutions had deficits in 1966. In 1967 the number jumped to 14. As a matter of fact, the deficit of 96 million dollars projected for 1978 might never be reached because a number of our institutions may well be forced to close their doors in the face of continued and growing deficit operations. It is obvious that, in order to avoid these projected deficits and the closing of some of our member institutions, it will be necessary to raise considerable funds, a significant part of which we expect to receive by way of private donations.

We point out that the operations of our members and those of similar institutions throughout the United States serve two purposes: not only do they help to fulfill the tremendous and critically important educational needs which this country must satisfy to continue to grow and prosper, but they also perform this function at little expense to the taxpaying public. Had these institutions not been established and had they not grown as they have, the direct burden on the taxpayers would be enormous. Congress has historically recognized these facts and for the past fifty-two years has provided tax incentives which have encouraged donations to these institutions. This is why we were not only alarmed but

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also startled by some of the alleged reform proposals pertaining to charitable contributions which are reflected in H.R. 13270.

We wish to make it quite clear that our members, without exception, believe that no donor should profit from his gift. Thus, there are certain provisions in the bill which we do not challenge because we recognize the need for true tax reform. There are, however, other provisions in the House-passed bill which cannot be classified as "reform" measures. Moreover, these latter provisions would have disastrous impact upon all of our institutions.

Under the House-passed bill a charitable contribution of appreciated property would be classified as a "tax preference." The bill in effect imposes a limitation by way of a ceiling on the maximum amount of tax preferences which an individual could claim as deductions in any one year. That ceiling would equal 50% of a taxpayer's adjusted gross income plus his tax preferences. For this purpose, the items of tax preference are: (1) the excluded one-half of net long-term capital gains; (2) tax-exempt interest on state and local bonds (included in limited tax preferences gradually over the next ten-year period); (3) the excess of accelerated depreciation over straight-line depreciation; (4) certain

farm losses; and (5) charitable contributions of appreciated property. However, in no case would an individual's deductible tax preferences be reduced below $10,000.

The House bill also provides that an individual must allocate certain personal deductions between his taxable income and his allowable tax preference items (to the extent that the latter exceed $10,000) with a resulting nondeductibility of that portion of such deductions allocable to the latter. For example (and ignoring the $10,000 floor), a taxpayer whose income is divided equally between his taxable income and his tax preference income would be allowed to claim only one-half of his otherwise allowable personal deductions. For this purpose, the tax preference items are generally the same as those five listed in the preceding paragraph (with certain adjustments) plus the excess of intangible drilling expenses over the amount of expenses which would have been recovered through straight-line depreciation and the excess of percentage depletion over cost depletion. However, for purposes of allocation, these items of tax preference are taken into consideration only to the extent that they have not exceeded the ceiling thereon which was described in the preceding paragraph. The personal expenses which must be allocated include in-

terest, taxes, personal theft and casualty losses, medical expenses and the charitable deduction.

Initially, we must express our alarm with the obvious complexities of these provisions without even commenting on their substance. Just by examining these complexities, a taxpayer may well be discouraged from making charitable contributions. Moreover, and more importantly, the classification of gifts of appreciated property as a tax preference for purposes of both the limitation on tax preferences and the allocation of deductions provisions is illogical and inequitable.

Present law and the provisions in the House-passed bill place certain direct percentage limitations on charitable contributions which act as a simple but effective restriction upon the amount of contributions which a particular taxpayer may claim as a deduction. For this reason alone, there is little justification for further limiting the deduction for charitable contributions by classifying gifts of appreciated property as a tax preference.

Unlike the other tax preference items, a taxpayer realizes no economic benefit from making a gift to charity. In fact, those other items add nontaxed cash dollars to his income. On the other hand, in the

case of a gift to charity, the taxpayer must bear the financial burden without the promise of a corresponding financial benefit. It is thus obvious that, when he approaches his limitation on tax preferences or faces a reduction of his deductions for personal expenditures, he will attempt to conduct his affairs in such a way as to avoid as much as possible that limitation or the loss of any deductions. Of all the so-called tax preferences, the contribution of appreciated property to a charity will be the first which he will reduce or eliminate because it is the only one which promises him no financial benefit and will result in a cost to him in any event. Moreover, the inclusion of charitable gifts in the deductions which would be disallowed in the event of an allocation of deductions would result in an even greater discrimination against charitable gifts because here, too, the taxpayer would often forego making such gifts in lieu of reducing or eliminating those items of tax preference which promise him financial reward.

Since 1917 Congress has encouraged deductions for contributions to nonprofit educational organizations because it has recognized the significant and

essential role which such organizations play in the continuing development of our society in this great nation. However, and as pointed out above, by classifying gifts of appreciated property as an item of tax preference for purposes of the limitation on such items and the allocation of deductions and by including charitable gifts in those personal deductions which are subject to allocation, Congress will discourage the very gifts which it has historically sought to encourage and unfairly discriminate against those who make them. As a result of such a classification, Congress would create frequent situations in which a donor would find himself unable to make a gift which he would have otherwise made with significant cost to himself under present law. We do not believe that, upon reflection, Congress would desire such a result because it conflicts with its historical position and would deal a serious blow to higher education.

The final area of proposed changes in the present tax law which so profoundly concerns us relates to those provisions which would or could have an effect on gifts involving charitable remainder trusts, annuities, and life income contracts. A charitable

remainder trust, simply stated, is the placing of property in trust with the income thereon payable to the donor for life and the remainder given to a charity at his death. The annuity is a contract by which the recipient charity agrees to pay an annuity to the donor for his lifetime as a result of his making a gift to that charity. The life income contract is an agreement by which the charity pays to the donor an annual income over his lifetime at the rate of the average annual net yield earned by the charity on that part of its pooled investment fund which is proportionate to the value of the donor's gift. Essentially, each of these three types of gifts allows a donor to make an immediate gift to a charity but retain an assured income for life. Also, in the great majority of cases, the donor not only reserves a life income to himself but also reserves a life income for his surviving spouse or minor or handicapped dependents.

Obviously, these types of gifts are advantageous both to the donor and donee. The donor is able to satisfy his desire to aid a charity by making the gift at present and yet be assured that he will have an income for life. The charity is presently assured of receiving funds and

is therefore able to plan accordingly. The importance of these gifts cannot be over-emphasized. In the case of many independent nonprofit educational institutions the annual value of these gifts represents 25 to 50% of the contributions which they receive each year.

That the provisions in the House-passed bill would discourage or eliminate these gifts is not open to question. For example, one of our member institutions which expected to receive such a gift which would have eventually resulted in the receipt of at least two and one-half million dollars is no longer assured of receiving that gift. Another was to receive such gifts totaling one and one-quarter million dollars and now faces the loss of those gifts. In such cases, the negative impact of the House-passed bill has been the reason why the gifts were not completed. For these most important reasons, we ask the Committee to modify those provisions in the bill discussed below which would or could have an adverse effect on these three types of gifts:

(a) Subsection 121(d) of the bill provides that certain debt-financed income would be subject to tax if it arises with respect to property acquired with borrowed funds and the production of the income therefrom is unrelated

to the purpose constituting the basis of the recipient organization's tax exemption. This tax, however, is inapplicable to income-producing property acquired in exchange for a gift annuity when certain tests are met. While it is unlikely, considering the purpose of these provisions, that they should or would apply to gifts subject to life income contracts, the question is not free from doubt. Therefore, we request that this subsection of the bill be clarified to make it inapplicable not only to income-producing property acquired in exchange for an annuity but also to that acquired in exchange for a life income contract. In this respect, we point out that the reasons for excluding an annuity from application of these provisions would be equally applicable to the exclusion of a life income contract.

(b) Subsection 201(c) of the bill in the case of certain specified gifts of appreciated property requires the donor either to include such appreciation in his taxable income or

reduce his deduction by the amount of such appreciation. This choice applies to a charitable contribution of a future interest. In the experience of our member institutions, very few gifts of remainder interests involve anything other than appreciated property. Obviously, if the donor must pay a tax and yet part with the property, he would not make such a gift. Therefore, if this provision were enacted into law, this area of deferred giving would be foreclosed resulting in a severe blow to the revenues of private nonprofit educational institutions and thus to society as a whole.

(c) Where a taxpayer makes a sale of property to charity at less than its fair market value with the difference between the fair market value and the sales price representing a gift, Subsection 201(e) of the bill requires an allocation of his basis between the sale and the gift. Again, it would appear that this provision is not meant to apply to the three forms of gifts mentioned above, and such an application would be inappropriate. However,

in order to remove the doubt which would otherwise cloud these methods of giving, we request that this provision be amended to exclude clearly such gifts.

(d) Subsections 201(e) and (h) of the bill provide that no deduction will be allowed for purposes of the Federal income and estate taxes, respectively, for a gift of a charitable remainder interest of property subject to a prior estate in trust unless the trust is either a "charitable remainder annuity trust" or a "charitable remainder unitrust" as those terms are defined in Subsection 201(i) of the bill. Allegedly, these particular provisions were incorporated in the bill to provide assurance that the trust would not be administered in a manner which would jeopardize the value of the remainder interest to go to the charity. However, the particular means which the House chose to provide such protection would result in discouraging gifts. Therefore, we request that these provisions be deleted from the bill and that any substitute provisions simply provide that a deduction will be allowable for a

gift of a remainder interest where the charity acts as the trustee, for this would provide the protection desired. We also point out that it is unlikely that more than a few donors would make gifts of charitable remainders under the provisions included in the House bill because the definitions of an annuity trust and a unitrust exclude trusts where more than one life estate is involved; thus, because most donors wish to provide for their surviving spouse or handicapped or minor dependents, they would seldon make such gifts.

We further note that certain provisions pertaining to charitable trusts are unfairly and unreasonably retroactive. Subsection 201(e) is applicable to gifts made on or after April 23, 1969, even though donors were not put on notice that such provisions might be enacted into law until August 1, 1969, the day upon which the House bill was reported out of the Committee on Ways and Means. In fact, several of our member institutions received gifts after April 22, 1969 from donors who were relying on the provisions of present law.

Subsection 201(h) would deny a charitable deduction for Federal estate tax purposes with respect to certain existing charitable remainder trusts. Subsection 201(f) would deny the deduction now available for purposes of the Federal income tax to existing trusts in the amount of any capital gains which are permanently set aside for charity. Both of these subsections would be applicable even if the trust was established long prior to August 1, 1969 and was irrevocable as of that date. The retroactivity of all three of these provisions is patently unreasonable and unfair and would result in undue hardship on all parties.

The bill has been carefully studied by the legal advisors of our member institutions as well as the legal counsel of the Association of Independent California Colleges and Universities. It is our considered opinion that the House-passed version of the "Tax Reform Act of 1969" might well have the most profoundly detrimental impact on independent higher education in the United States in its history. This restrictive measure would come, not at a time of lessening demand or need, but during a period of unprecedented challenge and constantly widening horizons.

We urge you, therefore, to consider with the utmost care the present tax incentives to charitable giving before making any changes. It is essential that, in your understandable zeal and well-warranted

concern to distribute the tax burden more equitably and to correct present abuses, you do not penalize the private sector of higher education which has contributed so much to the unique fabric that is our American society.