

# IMPACT OF CURRENT ECONOMIC CRISIS ON FOUNDATIONS AND RECIPIENTS OF FOUNDATION MONEY

---

---

HEARINGS  
BEFORE THE  
SUBCOMMITTEE ON FOUNDATIONS  
OF THE  
COMMITTEE ON FINANCE  
UNITED STATES SENATE  
NINETY-THIRD CONGRESS  
SECOND SESSION

NOVEMBER 25 AND 26, 1974

Printed for the use of the Committee on Finance



U.S. GOVERNMENT PRINTING OFFICE

42-903

WASHINGTON : 1974

---

For sale by the Superintendent of Documents, U.S. Government Printing Office  
Washington, D.C. 20402 - Price (\$3.05)

STOCK NO. 052-070-2752

BEST COPY AVAILABLE 3561-12  
12  
78

**COMMITTEE ON FINANCE**

**RUSSELL B. LONG, Louisiana, *Chairman***

**HERMAN E. TALMADGE, Georgia**  
**VANCE HARTKE, Indiana**  
**J. W. FULBRIGHT, Arkansas**  
**ABRAHAM RIBICOFF, Connecticut**  
**HARRY F. BYRD, Jr., Virginia**  
**GAYLORD NELSON, Wisconsin**  
**WALTER F. MONDALE, Minnesota**  
**MIKE GRAVEL, Alaska**  
**LLOYD BENTSEN, Texas**

**WALLACE F. BENNETT, Utah**  
**CARL T. CURTIS, Nebraska**  
**PAUL J. FANNIN, Arizona**  
**CLIFFORD P. HANSEN, Wyoming**  
**ROBERT DOLE, Kansas**  
**BOB PACKWOOD, Oregon**  
**WILLIAM V. ROTH, JR., Delaware**

**MICHAEL STERN, *Staff Director***

---

**SUBCOMMITTEE ON FOUNDATIONS**

**VANCE HARTKE, Indiana, *Chairman***

**J. W. FULBRIGHT, Arkansas**  
**MIKE GRAVEL, Alaska**

**CARL T. CURTIS, Nebraska**  
**PAUL J. FANNIN, Arizona**

**ROBERT WILLAN, *Tax Counsel***

(11)

# CONTENTS

---

## ADMINISTRATION WITNESS

Alexander, Hon. Donald C, Commissioner, Internal Revenue Service, accompanied by:	Page
Burke Willsey, Assistant to the Commissioner, IRS;	
Leon C. Green, Regional Commissioner, Central Region, IRS;	
Meade Whitaker, Chief Counsel, IRS;	
Alvin Lurie, consultant;	
Charles Rumph, consultant; and	
Howard Schoenfeld.....	1

## PUBLIC WITNESSES

American Council on Education, John Ryan, president, Indiana University, accompanied by:	
John Morse, director, Office of Government Relations, American Council on Education.....	218
Associated Colleges of the Midwest and the Great Lakes Colleges Association, Thaddeus Seymour, president, Wabash College.....	224
Augsberger, Robert R., vice president for business and finance, Stanford University.....	253
Babcock Foundation, Mary Reynolds; William L. Bondurant, executive director.....	243
Bolling, Dr. Landrum R., executive vice president, Lilly Endowment, Inc., accompanied by:	
Thomas Lofton.....	178
Bondurant, William L., executive director, Mary Reynolds Babcock Foundation.....	243
Bonine, Robert, executive secretary, Minnesota Council on Foundations..	191
Carnegie Corp. of New York, F. Lee Jacquette, treasurer.....	162
Cleveland Foundation, Homer Wadsworth, director.....	234
Council on Foundations:	
Robert F. Goheen, chairman.....	74
David Freeman, president.....	197
Ford Foundation, Roger G. Kennedy, vice president for financial affairs; and Harold Howe II, vice president, division of education.....	90
Fox, H. Lawrence, Pew Memorial Trust.....	121
Freeman, David, president, Council on Foundations.....	197
Fremont-Smith, Marion, Choate, Hall & Stewart.....	200
Goheen, Robert F., chairman, Council on Foundations.....	74
Great Lakes Colleges Association, Associated Colleges of the Midwest, Thaddeus Seymour, president, Wabash College.....	224
Hanks, Nancy, chairman, National Endowment for the Arts.....	172
Howe, Harold, II, vice president, division of education, Ford Foundation; and Roger G. Kennedy, vice president for financial affairs, Ford Foundation.....	90
Huffaker, John B., Pepper, Hamilton, & Scheetz.....	107
Jacquette, F. Lee, treasurer, Carnegie Corp. of New York.....	162
Janeway, Elliot, economist.....	37
Kellogg Foundation:	
Dr. Russel G. Mawby, president.....	118
James W. Riddell, counsel.....	120
Kennedy, Roger G., vice president for financial affairs, Ford Foundation; and Harold Howe II, vice president, division of education, Ford Foundation.....	90
Knowles, John H., president, Rockefeller Foundation.....	42

IV

	Page
Lilly Endowment, Inc., Dr. Landrum R. Bolling, executive vice president, accompanied by :	
Thomas Lofton .....	178
Mawby, Dr. Russell G., president, Kellogg Foundation.....	118
Minnesota Council on Foundations, Robert Bonine, executive secretary--	101
National Endowment for the Arts, Nancy Hanks, chairman.....	172
O'Neill Center, George White, president.....	259
Pew Memorial Trust :	
H. Lawrence Fox.....	121
Robert Smith.....	116
Riddell, James W., counsel, Kellogg Foundation.....	120
Rockefeller Foundation, John H. Knowles, president.....	42
Ryan, John, president, Indiana University, on behalf of the American Council on Education, accompanied by :	
John Morse, director, Office of Government Relations, American Council on Education.....	218
Seymour, Thaddeus, president, Wabash College on behalf of the Associated Colleges of the Midwest and the Great Lakes Colleges Association....	224
Smith, Robert, Pew Memorial Trust.....	116
Wadsworth, Homer, director, Cleveland Foundation.....	234
White, George, president, the O'Neill Center.....	259

COMMUNICATIONS

Aetna Life & Casualty, John H. Filer, chairman.....	322
Alexander, Edward P., director of museum studies, University of Delaware .....	318
Alexander, Hon. Donald C., Commissioner, Internal Revenue Service....	335, 340
Allen, William W., vice president, Elsa U. Pardee Foundation.....	290
American Association of Presidents of Independent Colleges and Universities .....	282
Anderson Foundation, John W., Edward C. Larson, chairman.....	277
Ash, James O., Hawkins, Ash, Baptle, and Co.....	305
Association of Art Museum Directors, Charles van Ravenswaay, director, Henry Francis du Pont Winterthur Museum.....	312
Baker, R. Palmer, Jr., Lord, Day and Lord.....	309
Baldwin, William H., president, Kresge Foundation.....	308
Bentley Foundation, Alvin M., Norman L. Des Jardins, vice president....	283
Benz, Obie, president, Vanguard Foundation.....	276
Bittker, Boris I., Yale Law School.....	320
Blackwelder, Justin, Environmental Fund.....	311
Bolling, Landrum R., executive vice president, Lilly Endowment, Inc....	292
Brannon, Gerard M., chairman, department of economics, Georgetown University .....	320
Brown, William J., attorney general, State of Ohio.....	310
Bundy, McGeorge, president, Ford Foundation.....	95
Busler, Robert H., secretary-treasurer, Hallmark Educational Foundation .....	304
Carnegie Corp. of New York, Eli Evans.....	304
Center for Advanced Study in the Behavioral Sciences, Aaron Wildavsky....	306
Church of Jesus Christ of Latter-Day Saints, Edler John H. Vandenberg..	303
Clark Foundation, Walter Kerbel, executive secretary.....	296
Cleveland Foundation, Homer C. Wadsworth, director.....	241
Cohen, Sheldon S., Cohen and Uretz.....	302
Coles, James S., president, Research Corp.....	322
Community Service Society, Alvin L. Schorr.....	307
Cook Foundation, David C., A. C. Montgomery, director.....	318
Cornwall, Joseph C., president, Fund for New Jersey.....	275
Corwin, F. W., executive secretary, Jackson Foundation.....	298
Council for American Private Education, Robert L. Lamborn, executive director .....	302
Council on Foundations, Edward G. Thomson, executive associate.....	90
Cummings Foundation, Inc., James H., F. Taylor Root, executive director .....	305
Danforth Foundation, Gene L. Schwilck, president.....	209

	Page
Davidoff, Paul, executive director, Suburban Action.....	285
Dow Foundation, Herbert H. and Grace A., Herbert H. Dow, president.....	203
Environmental Fund, Justin Blackwelder.....	311
Etherington, Ted.....	310
Evans, Eli, Carnegie Corp. of New York.....	304
Ewing, Bayard, Tillinghast, Collins, & Graham.....	295
Fels Fund, Samuel S., Nochem S. Winnett, president.....	303
Filer, John H., chairman, Aetna Life & Casualty.....	322
Flynn, Edward J.....	307
Frey, Edward J., Union Bank & Trust Co., National Association.....	298
Fund for New Jersey, Joseph C. Cornwall, president.....	275
Glasgow, Nancy M., president, National Association of Foundations, Inc....	207
Grimshaw, William F., director of information, Charles Stewart Mott Foundation.....	319
Guenzel, Robert C., Crosby, Guenzel, Kessner & Kuester.....	290
Haas, Paul R.....	305
Hallmark Educational Foundation, Robert H. Busler, secretary-treasurer...	304
Hanes, R. Phillip Jr.....	270
Harriss, C. Lowell, professor of economics, Columbia University.....	277, 299
Harrower, Norman, Jr., director, New Haven Foundation.....	312
Hartke, Hon. Vance, a U.S. Senator from the State of Indiana.....	94, 338
Heinz Endowment, Howard, Alfred W. Wishart, Jr., executive director.....	292
Hogg Foundation for Mental Health, Robert L. Sutherland.....	291
Horton, Thomas R., International Business Machines Corp.....	302
Huffaker, John B., Pepper Hamilton and Scheetz.....	301
Hunt, Peter, executive director, Urban Dynamics/Inner City Fund.....	281
International Business Machines Corp., Thomas R. Horton.....	302
Jackson Foundation, F. W. Corwin, executive secretary.....	298
Jardins, L. Dea, vice president, Alvin M. Bentley Foundation.....	288
Jenny, Hans H., College of Wooster.....	324
Johns, Anna May, secretary and vice president, Elsa U. Pardee Founda- tion.....	289
Johnson Foundation, Robert Wood, David E. Rogers, M.D.....	291
Jones, Thomas B., Merrill Lynch, Pierce, Fenner & Smith, Inc.....	300
Jordan, Vernon E., Jr., executive director, National Urban League, Inc....	280
Josey, Jack S., president, Robert A. Welch Foundation.....	280
Kerbel, Walter, executive secretary, Clark Foundation.....	296
Kirkpatrick, John E.....	301
Kresge Foundation:	
William H. Baldwin, president.....	308
Alfred H. Taylor, Jr., vice president for administration.....	308
Lamborn, Robert L., executive director, Council for American Private Education.....	302
Larson, Edward C., chairman, John W. Anderson Foundation.....	277
Leavitt, Thomas W., director, Merrimack Valley Textile Museum.....	282
Lilly Endowment, Inc., Landrum R. Bolling, executive vice president.....	292
Lumpkin Foundation, R. A. Lumpkin.....	298
McClellan, Hon. John L., a U.S. Senator from the State of Arkansas.....	320
McDaniel, Paul R., professor of law, Boston College Law School.....	320
Markle Foundation, John and Mary, Lloyd N. Morrisett.....	291
Merrill Lynch, Pierce, Fenner & Smith, Inc., Thomas B. Jones.....	300
Merrimack Valley Textile Museum, Thomas W. Leavitt, director.....	282
Mitchell, F. C., secretary, Oakland Scottish Rite, Scaife Scholarship Foundation.....	300
Montgomery, A. C., director, David C. Cook Foundation.....	318
Moore, E. H., certified public accountant.....	295
Morrisett, Lloyd N., John and Mary Markle Foundation.....	291
Mott Foundation, Charles Stewart; William F. Grimshaw, director of information.....	319
National Association of Foundations, Inc., Nancy M. Glasgow, president...	207
National Urban League, Inc., Vernon E. Jordan, Jr., executive director....	280
New Haven Foundation, Norman Harrower, Jr., director.....	312
Oakland Scottish Rite, Scaife Scholarship Foundation, F. C. Mitchell, secretary.....	306

	<b>Page</b>
Pardee Foundation, Elsa U.; Anna May Johns, secretary and vice president .....	289
Philadelphia Foundation, Sidney N. Repplier, director.....	304
Ravenswaay, Charles van, director, Henry Francis du Pont Winterthur Museum, on behalf of the Association of Art Museum Directors.....	312
Repplier, Sidney N., director, Philadelphia Foundation.....	304
Research Corp., James S. Coles, president.....	322
Rogers, David E., M.D., Robert Wood Johnson Foundation.....	291
Root, F. Taylor, executive director, James H. Cummings Foundation, Inc..	305
Sanford Terry, Duke University.....	292
Scholten, Harvey L., Scholten and Fant.....	297
Schorr, Alvin L., Community Service Society.....	307
Schwilck, Gene L., president, Danforth Foundation.....	299
Sloan, Alfred P. Foundation, Nils Y. Wessell.....	296
Sommer, Sebastian C., executive director, Winston-Salem Foundation.....	310
Suburban Action, Paul Davidoff, executive director.....	285
Sutherland, Robert L., Hogg Foundation for Mental Health.....	291
Taylor, Alfred H., Jr., vice president for administration, Kresge Foundation .....	308
Thomson, Edward G., executive associate, Council on Foundations.....	90
Union Bank & Trust Co., National Association, Edward J. Frey.....	298
Urban Dynamics/Inner City Fund, Peter Hunt, executive director.....	281
Wadsworth, Homer C., director, Cleveland Foundation.....	241
Wallace, John A., King & Spalding.....	800
Welch Foundation, Robert A., Jack S. Josey, president.....	289
Wessell, Nils Y., Alfred P. Sloan Foundation.....	296
Wildavsky, Aaron, Center for Advanced Study in the Behavioral Sciences .....	306
Winnett, Nochen S., president, Samuel S. Fels Fund.....	303
Winston, Ellen.....	297
Winston-Salem Foundation, Sebastian C. Sommer, executive director.....	310
Wishart, Alfred W., Jr., Howard Heinz Endowment.....	292
Vandenberg, Elder John H., Church of Jesus Christ of Latter-Day Saints..	303
Vanguard Foundation, Oble Benz, president.....	276

#### APPENDIX A

Communications received by the committee expressing an interest in these hearings .....	267
---	-----

#### APPENDIX B

Communications submitted to the Subcommittee on Foundations in response to a subcommittee request for views on the impact of the Tax Reform Act of 1969 on foundations and recipients of foundation grants.....	289
---	-----

#### APPENDIX C

Material offered for the record or requested by members of the subcommittee .....	329
---	-----

#### APPENDIX D

Communications with the Internal Revenue Service.....	335
---	-----

# IMPACT OF CURRENT ECONOMIC CRISIS ON FOUNDATIONS AND RECIPIENTS OF FOUNDATION MONEY

MONDAY, NOVEMBER 25, 1974

U.S. SENATE,  
SUBCOMMITTEE ON FOUNDATIONS  
OF THE COMMITTEE ON FINANCE,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 9:45 a.m., in room 2221, Dirksen Senate Office Building, Senator Vance Hartke (chairman of the subcommittee) presiding.

Present: Senators Hartke [presiding], Curtis, and Fannin.

Senator CURTIS [presiding]. The committee will come to order.

Chairman Hartke is delayed a bit, but we will proceed because we do appreciate that the witnesses are present.

This meeting of the Subcommittee on Foundations is called primarily to assess the present situation, both as to economic factors as well as the effect of the present law on foundations and on grantees.

Our first witness is the Commissioner of the Internal Revenue, and Mr. Alexander, we are delighted to have you here. You may proceed in your own way. If you have a written statement you can follow that, or please proceed.

**STATEMENT OF HON. DONALD C. ALEXANDER, COMMISSIONER, INTERNAL REVENUE SERVICE, ACCOMPANIED BY MR. BURKE WILLSEY, ASSISTANT TO THE COMMISSIONER, INTERNAL REVENUE SERVICE; MR. LEON C. GREEN, REGIONAL COMMISSIONER, CENTRAL REGION, INTERNAL REVENUE SERVICE; MR. MEADE WHITAKER, CHIEF COUNSEL, INTERNAL REVENUE SERVICE; MR. ALVIN LURIE, CONSULTANT; MR. CHARLES RUMPH, CONSULTANT; AND MR. HOWARD SCHOENFELD**

Mr. ALEXANDER. Thank you, Mr. Chairman.

I have a written statement, and with your permission, Senator Curtis, I would prefer not to read it, but instead to submit it for the record.

Senator CURTIS. Very well. So ordered.

Mr. ALEXANDER. But I would like to tell you first who are here from Internal Revenue before you, why they are here, and to outline briefly some of the considerations as we see them from the perspective of our responsibilities.

First, who are here: On my immediate right, Senator Curtis, is Leon Green, our Regional Commissioner for the Central Region, and at the

time of the creation of the Special Service Staff, discussed in the press recently, Mr. Green was Deputy Assistant Commissioner (Compliance) in the National Office of the Internal Revenue Service. On my immediate left is Meade Whitaker, Chief Counsel of the Internal Revenue Service, and on Mr. Whitaker's left is Burke Willsey, Assistant to the Commissioner. Behind Mr. Whitaker is Alvin Lurie who we persuaded to be a consultant, and who we hope and expect will be our new Assistant Commissioner in charge of Employee Plans and Exempt Organizations—in charge of our new and expanded and re-defined functions in the exempt organizations area in its entirety and with respect to private foundations in particular.

To Mr. Lurie's right is Charles Rumph. Charles Rumph was formerly deputy attorney general of the State of California in charge of enforcing their laws with respect to charities. He has joined the Internal Revenue Service and is acting now as a consultant to me. He will be working with Mr. Lurie shortly.

To Mr. Rumph's right is Howard Schoenfeld, now of our Exempt Organizations Examinations Branch, under the Assistant Commissioner (Compliance). He will soon be working directly in the employee plans and exempt organizations area.

Senator Curtis, we have responded, and the statement that I mentioned responds further, to a letter of inquiry from your subcommittee with respect to certain information that the subcommittee needs in order to evaluate the effect of the 1969 Revenue Act upon the private foundation community, to see whether provisions brought into the tax laws as part of chapter 42 of the Code are having their intended effect, are having too great an effect, or perhaps too little an effect.

We have submitted a substantial amount of information to this subcommittee describing what we have done in the past and what we are doing now to be more responsive to the needs of Congress in evaluating the impact of the new design in the statute regarding private foundations.

First, Senator Curtis, I have to tell you that the figures that we gave, the \$17.3 billion figure that we estimated as being the aggregate of foundation assets as reported to us, is just plain wrong, and it is wrong for a reason and in a way that almost defies belief. We ran a new computer program this summer to record the assets of foundations as reported to us on their 990's. The computer program involved 12 digits, but the Honeywell system was programed to take only 10 digits, so guess what digits were dropped: the left-hand digits, not the cents, but the left-hand digits. So a foundation with \$1 billion or more in assets turned out to be a foundation whose assets were reported as those in the \$10 million to \$99 million category.

Senator CURTIS. Well, it makes it easier to understand, anyway. [General laughter.]

Mr. ALEXANDER. Well, it does make it quite easy to understand, but let me tell you something our computer program did later. After we knocked off the two left-hand figures, then we had some interesting material which, of course, was meaningless, but then we knocked the cents off, so we knocked off the two right-hand figures. Therefore, we do not even give you the total cents, much less the total dollars.



Now, we have found this mistake, and it is an inexcusable mistake, and we are correcting it. We will have some better figures for the use of this subcommittee in the very near future.

Now, Mr. Chairman, this illustrates something about the past, about the present, and about the future. Our interest in exempt organizations in the past has not been as great as it should have been. Our assemblage of statistics, even if we assembled them correctly, has not been as detailed as it should have been. We are redesigning, reformatting, and rethinking what we will require on our tax returns, what we will put in our exempt organizations master file, what we will supply to Congress, to the foundation community, and to the public. We have redesigned our audit program, as well.

For 5 years we have been concentrating on private foundations to fulfill a commitment that Commissioner Thrower made down here at the Hill, that all foundations would be audited at least once during this 5-year period, and that the larger foundations would be audited on a 2-year cycle. That commitment is now being fulfilled. It will be fulfilled by the end of this year.

We do not propose to continue an audit program of this kind. We propose, instead, to have a taxpayer compliance measurement program to determine the real audit needs of the exempt organizations community, and to go about a more effective and a completely even-handed way of meeting our responsibilities, to see to it that the provisions governing exempt organizations are administered soundly, effectively, and even-handedly.

I apologize for the fact that the information about the aggregate assets of foundations was so far off. I want to commend the subcommittee upon the disbelief that it evidenced when it inquired as to how this \$17.3 billion figure came about.

Senator Hartke, I would like, if I may, sir, to quote to you a statement of yours in the June 3, 1974 hearings:

It is imperative that the I.R.S. conduct its activities with a full sense of its responsibilities. If it allows its awesome power and information to be used by anyone for selfish political purposes, it fails in performing its tasks and ceases to deserve public trust.

I agree with that completely. Various statements have been made in the press recently about the Special Service Staff, started as the Activist Organizations Committee, or a name of that type, and terminated by me on August 9, 1973. Allegations have been made about why this organization was created, at whose request it was created, about what it did or did not do, about what statements were made or were not made when it was terminated, and about what happened or is happening to the files of this organization.

Now, I can speak and I would like to speak very briefly as to some of these issues on hand. Senator Hartke, as a former prosecutor, you know that hearsay is a lot less valuable than direct testimony, and Leon Green, our Regional Commissioner of the Central Region, who was formerly Deputy Assistant Commissioner (Compliance) at the time of the creation of this organization, is here to tell this subcommittee briefly why this organization was created and what it did when he was here.

As to its termination, on May 30, 1973, the day after I was sworn in as Commissioner, I called a meeting to discuss this organization and to see whether there was any good reason for continuing it. At that meeting there were present Mr. Burke Willsey, my assistant, who is on my far left at this table; the then Deputy Commissioner, Mr. Raymond F. Harless, Mr. Dean Barron, the then Assistant Commissioner, Accounts, Collection and Taxpayer Service; Mr. Harold Snyder, the then head of the Collection Division, and Mr. Paul Wright, who was then head of the Special Service Staff.

I was assured at that meeting that the staff was engaged only in obtaining information about tax protesters and tax resisters, people who were trying to impede the Internal Revenue Service from carrying out its responsibilities to administer and enforce the tax laws.

Mr. Harless and Mr. Barron, with the others, asked that this organization be continued, and it was continued on a trial basis for that purpose, until it was terminated by me on August the 9th.

Senator HARTKE [presiding]. August when?

Mr. ALEXANDER. August 9, 1973.

The documents carrying out this termination were signed on August the 13th.

Now, first, what was stated on August the 9th to the Internal Revenue Service and to the public, because some reporters seem to be confused on this issue, and this issue is important—the release of August the 9th speaks for itself, pointing out that the staff was formed as a result of inquiries made of I.R.S. by the permanent Subcommittee on Investigations of the Senate Committee on Government Operations. It then points out that the assignment of the staff was to gather information on the sources of funding of so-called extremist organizations and to check the income tax status of the organizations and their principals.

Then the release says that the staff is presently involved in matters dealing with tax resisters and tax protesters.

After the announcement on August the 9th, and the ministerial documents that followed on August the 13th, the staff then set about to terminate its operations, to distribute to field offices information with respect to people and institutions that it thought involved non-compliance with the tax laws.

Mr. Willsey can speak about these activities as he was handling this for my office. The files of the staff have been maintained intact and are still maintained intact. They were maintained intact at the express request of Senator Ervin on behalf of his Subcommittee on Constitutional Rights, and at the request of the chief of staff of the Joint Committee on Internal Revenue Taxation because the Joint Committee has not completed the investigation which it began last year and which it reported on briefly in its report of December 20, 1973.

As soon as these investigations are completed, I would like—and I hope to get—permission to take these files and have the biggest bonfire on the ellipse since 1814.

Senator HARTKE. You want to deep six them, you mean.

Mr. ALEXANDER. No; I do not want to deep six. Deep six involves a private undertaking and water.

Senator HARTKE. You just want to get rid of them. I understand. I can agree.

Mr. ALEXANDER. I want to get rid of them because in my judgment, Mr. Chairman—and I know in the judgment of the fine career people of the Internal Revenue Service, we have the responsibility of administering the laws totally without regard to whether someone's political view may be to the left or to the right or up or down or sideways. We have to determine whether organizations which claim exemption are actually entitled to exemption, and that is why we have to determine whether an organization may be a so-called action organization within that definition of the Internal Revenue Regulations.

Sure we do, and we have to determine whether people are filing returns when they are required to file them, and whether they are paying taxes that they are required to pay, and we have to make these determinations totally without regard to these irrelevant considerations that are the subject of your statement that I was glad to read into this record.

Now, I would like to—if we can impose on the time of the subcommittee, Mr. Chairman, I think it might be helpful from the standpoint of the private foundation community and the community of exempt organizations as a whole to have Mr. Green, who was present at the birth of the special service staff, tell you who the parents were.

Senator HARTKE. All right, fine.

Mr. GREEN. Mr. Chairman, I would like to very briefly lay a little bit of background for this subject. As the Commissioner noted, during the period of time involved—

Senator HARTKE. Now, let me ask you something.

Can you hear in the back of the room?

VOICES. No.

Senator HARTKE. Let me explain to you, that is not your fault. These microphones, you have to be practically into them.

Mr. GREEN. Is that better?

Senator HARTKE. Yes.

Unfortunately, I am sorry we cannot have a better system here.

Mr. GREEN. As the Commissioner noted at the time in question, my position was Deputy Assistant Commissioner for Compliance.

Senator HARTKE. Deputy what?

Mr. GREEN. Deputy Assistant Commissioner for Compliance.

Senator HARTKE. For compliance?

Mr. GREEN. National office.

As early as August of 1968 we were advised by investigators for the Senate Permanent Subcommittee on Investigations that the committee was looking into various groups then engaged in various types of civil disorders. The committee was operating under an Executive order at that time, signed by President Johnson, and subsequently another Executive order signed by President Nixon, authorizing access to tax information in connection with matters pending before the committee.

On September 19, 1968—I think these dates become important in the total, overall picture—the chairman of the Senate committee submitted to then Secretary of Treasury Fowler a list of 22 entities for which he asked that Senate investigators be permitted to inspect returns and related documents within the Internal Revenue Service. Attached to his letter, as I indicated, was a list of 22 entities.

Now, this list was identical to the list that was subsequently submitted by the chairman to Secretary Kennedy on March 5, 1969. This

list was identical to the one that the national office of the Internal Revenue Service sent to regional commissioners with the request for information on March 25, 1969.

Now, on several occasions subsequent to March 5, 1969, various personnel in the service met with or talked by telephone with investigators for the Senate permanent subcommittee. In contemporaneous memorandums of these conversations, the investigator is reported as having commented that the chairman had expressed disappointment and unhappiness over the fact that the Service had taken little action with regard to the 22 organizations. I assume, but I cannot say for certain that his reaction was based on the reviews conducted by the staff members of information in the files of the Internal Revenue Service under Executive order.

On June 25, 1969, I, along with other representatives from the Service, testified before the Senate permanent subcommittee regarding two specific organizations that were on the list of 22 previously submitted to the Internal Revenue Service. Although I had never had an opportunity—incidentally, that testimony was in executive session. I have never had an opportunity to read the transcript of that session, but my recollections I think are rather vivid and rather clear.

The committee had evidence of large sums of money flowing into these two organizations. As I recall, in some cases they could identify the source of funds flowing into the organizations. Committee members, and particularly the chairman, expressed surprise and criticism of the fact that the Service had not done more with regard to investigation of these two organizations to determine their taxable status and to determine whether funds donated to the activist organizations came from exempt organizations, and if so, the extent that the exempt status of the contributing organizations might be jeopardized, or whether funds flowing into the activist organizations were deducted on individual income tax returns as contributions in light of the fact that neither of the activist organizations at that time had been granted exempt status.

Quite frankly, when I left that session I was rather disturbed over a number of factors. I think if you recall that period of time in our history, there were numerous organizations that were very active in protest activities, some peaceful, many not so peaceful. Some were engaged in extreme violence. It was obvious to everyone, I believe, that these organizations were well financed. I felt then, and Mr. Chairman, I feel now that at that time the Service had a moral responsibility to determine the taxable status of the organizations involved, and whether the funds flowing into those organizations had any bearing on the tax status of any other individual or any other organizations.

Senator HARTKE. Now, let me ask you, you said a moral responsibility.

Did it have a legal responsibility?

Mr. GREEN. I believe it had, yes.

Senator HARTKE. On what basis?

Mr. GREEN. I think we have a legal responsibility to determine at any time the tax status of organizations and the tax liability of individuals.

Senator HARTKE. All right.

On what do you base that?

Mr. GREEN. I think that is the basic function of the Internal Revenue Service, Mr. Chairman.

Senator HARTKE. On what authority, on what specific authority in the statute?

Mr. GREEN. At this point I cannot formally cite a specific section. I would defer to counsel.

Mr. ALEXANDER. I think it is in sections 7601, 7602 of the Code, but my memory of the Code is not as good as it used to be, before I became an Administrator.

Mr. Chairman, let me state—

Senator HARTKE. Pull that microphone up again.

Mr. ALEXANDER. Mr. Chairman, I think we do have responsibility to administer the Internal Revenue laws, and enforce those laws.

Senator HARTKE. Yes; I understand you have responsibility.

Mr. ALEXANDER. But I think we have to exercise that, sir.

Senator HARTKE. Yes, but I did not understand exactly what Mr. Green said. I just asked a question as to where you find the legal authority for the specific action which you have just described, and which, of course, we are probably going to cover in some more detail.

Mr. GREEN. Well, Mr. Chairman, we—

Senator HARTKE. Do you have any specific authority?

Mr. ALEXANDER. Mr. Chairman, under section 7601, we are required periodically to canvass the various geographic regions in the country to see whether people may be liable to pay any tax; and that, as I recall, is one of the basic provisions directing us to carry out our function of—

Senator HARTKE. Let me get this into the context as I understood Mr. Green to put it. I understand that you received a letter from Senator McClellan, who is chairman of the Government Operations Committee—or did you receive an oral request?

Mr. GREEN. We received a letter. The Secretary of Treasury received a letter from Senator McClellan.

Senator HARTKE. Yes?

Mr. GREEN. In which he listed 22 organizations, and in which he requested that investigators of the committee be permitted to inspect returns and related documents in the service files, under an Executive order signed by President Nixon.

Senator HARTKE. Do you have a copy of that letter?

Mr. GREEN. I have a copy we can make available.

Senator HARTKE. You will make that available to the staff?

Mr. GREEN. Yes. Perhaps, Mr. Chairman, I could clarify.<sup>1</sup>

Senator HARTKE. Let me at this time have in the record what you are talking about; the authority upon which you say you have a legal as well as a moral authority. This deals with chapter 78, "Discovery of Liability, and Enforcement of the Title:" in section 7601 is entitled "The Canvass of Districts for Taxable Persons and Objects." And under subsection A, as I understand it, you are relying upon that, the general rule.

<sup>1</sup> See p. 329.

The Secretary or his delegate shall, to the extent he deems practicable, cause officers or employees of the Treasury Department to proceed from time to time to each Internal Revenue district, and inquire after and concerning all persons therein who may be liable to pay any Internal Revenue tax; and all persons owning or having the care and management of any objects with respect to which any tax is imposed.

I do not gather from your statement that you are going upon the question of collecting tax, but you are going upon the context or the atmosphere at that time which you ask me to recall, and which I recall very vividly, because I was not what you call one of the favorites upon Capitol Hill, or with most of the news media either, because I took a position against the war at that time, for example. And what I am asking you, do you think the simple fact that I took a position against the war would have given you the moral and legal responsibility—now, wait a minute, let me ask the question, do not get so anxious.

Do you think that because I was opposed to the war, and had been condemned by the President—I am not talking about this one, or the one before this one; I am talking about the one before the one before this one, President Johnson was his name—had been condemned publicly by him, that that would have been justification morally for you to move into a fashion for investigation, especially when “most are newsworthy, and many are controversial.”

What has that got to do with it? I mean, I am reading from a memorandum of Mr. Bacon now, to the Regional commissioners. Is that under your direction?

Mr. GREEN. That is my present position. I was not in that position at the time. But now, obviously, Senator, the answer to your last question is a complete and absolute and a positive no. But given the situation, where we receive information that an organization is receiving substantial sums of money—now, that organization is either exempt from income tax, or it is either subject to income tax. And if our files indicate that it has not applied for exempt status, has not been granted exempt status, and it has not filed a corporate or any type of income tax return, it is incumbent upon the Internal Revenue Service to follow through with that information to determine whether it is a taxable organization, and if so, to collect the appropriate tax.

Senator HARTKE. Yes. But the fact of it is, it was that the activity, the type of activity, has nothing whatsoever to do with the responsibility of the Internal Revenue.

Is that not correct?

Mr. GREEN. Yes; I would say—

Senator HARTKE. If they were going ahead and preparing the way for you to go to heaven—which I am sure you will—but if they were an organization preparing for you to go to heaven, and they said that they were going to sponsor the Ten Commandments, and go ahead and give us the Sermon on the Mount, do you think that that type of organization is any more exempt from paying its fair share of taxes?

Mr. GREEN. Absolutely not.

Senator CURTIS. Would the chairman yield right there?

Senator HARTKE. Yes; I would be glad to yield.

Senator CURTIS. I think that the thing needs a little clarification. Now, I believe we are all agreed that no one should be singled out, or

no organization should be singled out, for a tax investigation because of political opinions that they hold or express, either in favor of or in opposition to other individuals who might hold office. But that is not what is involved here. Is it not true that the statute sets forth what contributions and what expenditures can be made tax-free.

Is that not right?

Mr. GREEN. It determines the circumstances under which an organization can be exempt.

Senator CURTIS. Yes, or someone contributing to that organization, and it becomes a tax-free transaction.

Is that not right?

Mr. GREEN. That is right.

Mr. ALEXANDER. That is correct.

Senator CURTIS. And basically, that is for charitable, educational, and religious purposes, is it not? With some broad—

Mr. GREEN. Yes.

Senator CURTIS. And it excludes political.

Now, the question of whether or not activities are carried on that are not educational or charitable or religious, or the other qualifications of tax-exempt expenditures or contributions, that question goes directly to the issue of whether or not somebody owes some taxes, does it not?

Mr. GREEN. I would say it does, yes, sir.

Senator CURTIS. Yes.

If the activity that is questioned does not come within the purview of tax-exempt activities or contributions, is that not right?

Mr. GREEN. Yes, sir, that is correct.

Senator CURTIS. Yes.

Now, is it also true that the general public is encouraged to provide information and evidence of tax evasion and nonpayment of taxes?

Mr. GREEN. Nonpayment of taxes, but not necessarily evasion of taxes.

Senator CURTIS. But nonpayment of taxes; that is what I mean.

Mr. GREEN. Yes; as distinguished from it.

Senator CURTIS. And certainly, the Congress has the responsibility to inquire, not only about the administration of the tax laws, to see that everybody pays his just share and no more, but it also has a primary responsibility to become informed, and see whether or not the statutes need to be changed or modified or altered in any way.

Is that not correct?

Mr. GREEN. Yes, sir.

Senator CURTIS. Yes.

So, when a citizen or a Member of Congress observes an activity which does not fall in the general category of tax-exempt activities, for which contributions and expenditures could go, and he has reason to believe that tax-free money is involved, he has a perfect right, whether he be a citizen or Member of Congress, to bring that information to the Service.

Is that not right?

Mr. GREEN. Absolutely.

Senator CURTIS. Was it this latter type of activity that I have tried to describe that brought this particular unit into being that has been referred to here, dealing with these organizations?

Mr. GREEN. It was brought into being as the result of our receiving information of funds of money, sums of money going to these organizations. Our record that they had not filed for exemption, had not been granted an exempt status, and had not filed income tax returns. Now, I think we had two parts of that particular problem.

Senator CURTIS. And it had no relation to what people believed, or beliefs that they expressed?

Mr. GREEN. Absolutely not.

Senator CURTIS. Or had no relation to their support of or opposition to anybody in office?

Mr. GREEN. Absolutely not. Our experience at that time indicated that the organizations that were involved in these particular types of activities had one common characteristic; and that is, they completely ignored any responsibility under the Internal Revenue laws, and to the extent that we had information regarding funds available to them, in the absence of any record of them having made any attempt to meet their tax responsibilities, we had the authority—and indeed, I feel, the responsibility—to follow through on that information.

Senator CURTIS. Well, I have always felt that the Internal Revenue Service was more efficient and had more integrity than the average citizen had an opportunity to observe, and I still think so. And I am glad to see the record set straight that there has been no organized activity, or no activity either organized or unorganized, on the part of Internal Revenue Service to give harsher treatment to people because of their political view; whether they opposed or supported a war, whether they favored one candidate or another candidate. But you do have a responsibility to follow through and see what the expenditures are all about, to see whether or not they are subject to tax.

Is that not right?

Mr. GREEN. That is correct.

Senator CURTIS. That is all, Mr. Chairman.

Senator HARTKE. Go ahead. Did you have some more to say?

Mr. ALEXANDER. Mr. Chairman, could I request at this time that if the letter and list of 22 organizations of March 5, 1969, from Senator McClellan to the then-Secretary of the Treasury David Kennedy, if not a part of the record, that we can put it in the record.

Senator HARTKE. Yes. Let me say on this, I will have a list of documents, quite a substantial list of documents here which are going to be submitted as part of the record. But I did not have a copy of the letter. Do you have that now?

Mr. WILLSEY. Yes, sir. I have a copy of the letter.

Mr. ALEXANDER. We have it, and we would like to submit it at this time.

Senator HARTKE. We will put that in the record. But for the sake of the record, I would instruct staff that we like to keep these documents in such a form so we can have easy reference to them, rather than scatter them through the testimony themselves.<sup>1</sup>

Mr. GREEN. Immediately after testifying before the Senate permanent subcommittee, as I indicated, I had in my own mind some very serious concerns about our responsibilities in this area and after giving it considerable thought, I recommended to my superior that a staff

<sup>1</sup> See app. C, page 329.



which later became known at that time as the Activist Organization Staff be formed for the purpose of coordinating the receipt and the analysis of information regarding these organizations and similar type organizations, to determine whether there was any evidence or indication of potential evasion—or at least ignoring the responsibilities under the Internal Revenue Code. My recommendation to my superior was accepted. I realize that there can be reasonable differences of opinion of the best way to accomplish this type of a purpose, this type of an objective.

Be that as it may, my recommendation was that the staff be formed. It was adopted, and these events, and only these events, led to a meeting on July 2, 1969, whereby the staff was organized. And that is the background, Mr. Chairman, that led up to the organization of the staff. I might say that it was our intention—and I think our intention was expressed in the named staff at that time—that it would be a temporary and not a permanent part of the Internal Revenue Service organization.

Senator HARTKE. All right.

When you appeared here last June, before this subcommittee, Mr. Alexander, I asked you several questions about the existence and the operation of the so-called SSS—the Special Services Staff—within the Internal Revenue Service. And following that appearance, I submitted some supplementary questions to you on that subject, to which you replied in July.

I have some additional follow-up questions today. But before I do, I want to make it clear that we are not in any way trying to hold you responsible for the existence of the SSS. It was created long before you joined the service, and in no way do I intend to be critical of the way you have handled the matter, with the possible exception of the delayed, piece-by-piece fashion in which the information about the SSS has been released to the public. The committee interest in this area stems from a concern about the potential impact which a politicized IRS can have on exempt organizations, and on people who are related in one way or another to exempt organizations. I think that you would agree with me, that the best way to best serve the public interest would be for us to get all the facts on the table. If there is to be blame assessed for the existence of this group, I suppose it is going to have to be shared by a number of people in the Federal Government, and I am not at this time attempting to assess that blame. But I do want to get the facts so that this type of situation hopefully will never occur again. We have had far too much of that in our society already and I want to make people feel that this democracy is working for the benefit of the people, rather than for the benefit of the power brokers.

It is my information that the staff has submitted to you, late last week, the general areas of our concern, so that we can cover them; and I hope that the questions I ask you, and I may submit some additional questions after that, will parallel those areas of concern.

In your July 24 letter to the subcommittee, you stated, and I quote: "In general, the types of activist organizations that were within the purview of the Special Services Staff were those characterized as extremists on the right or the left." And you went on to note such general criteria as "One: violent groups advocating revolution against

the Government of the United States. Two: nonviolent groups, and three: stated tax resisters."

Now, the nonviolent group category that I just mentioned seemed to include most organizations within this country. Now, was that the intent of your reply?

MR. ALEXANDER. I am not completely sure that I understand the question, Mr. Chairman, and that is my fault, and not yours. But I will attempt—now that Mr. Howard Schoenfeld has given me the answer.

Although no formal definition of the term, "activist," was ever adopted, the organizations included those which could be classified: one, violent groups, and two, nonviolent groups, and three, stated tax resisters—well, the nonviolent groups; obviously, that qualification would include just about everybody there was.

Now, there were a lot of files here—11,400 some, here—as I recall, including a whole lot that grew like Topsy from the original 22 that were submitted to us by Senator McClellan. There was another 55, and another 22, and then others were added. These should have been within the category of the original groups or types that Mr. Green has described.

The so-called extremists on either side—I think one could be in that category without being in a violent group advocating revolution against the Government. So you could have a category much narrower than that very broad language in number two that would not be included in number one, and would not be included in number three, because number three is something called stated tax resisters.

Now, Mr. Schoenfeld, when you drafted this, what did you mean by this?

Senator HARTKE. He might as well come up here, if we are going to have Mr. Schoenfeld's testimony. We might as well have it firsthand, rather than having it vicariously.

MR. ALEXANDER. Absolutely, absolutely. Firsthand is better than hearsay.

If he does not know, I am going to ask Mr. Willsey.

MR. SCHOENFELD. Mr. Willsey can join in, if he can.

The first category of organizations that—well, let me first say that in trying to answer your question, what we did is try to develop the information in Internal Revenue Service files, and to categorize them in a way that would be helpful for you, Senator. And when investigating what kinds of organizations there were in these files, we found out they fell within these general broad categories: violent groups, where there was evidence that members of the organizations or the organizations themselves were carrying on violent activities. There was another group of organizations, a nonviolent group, and this included all those that would not fall within either group one or group three. These nonviolent groups were categorized—or would include organizations that simply, there was no record of any violence. But for some reason or other, there was a file made by the Special Services group. And the third class of organizations, stated tax resisters, were those organizations that espoused the cause of not complying with the tax laws of the United States, and this was one

kind of organization that the Special Services Staff had to maintain a file on.

Senator HARTKE. Were you with the organization, with the SS group organization, the SSS, at that time, or in the Service?

Mr. SCHOENFELD. I was with Internal Revenue, sir. I was not a member of the Special Service Staff, the activist organization, at any time. My information comes from speaking with members of the staff in an effort to put a reply together for you.

Senator HARTKE. In other words, your information is accumulated from other individuals that were involved?

Mr. SCHOENFELD. That is true, sir.

Senator HARTKE. All right.

In view of the criteria that have been established, how do these general criteria fit in with the fact that the Urban League, the Americans for Democratic Action, Unitarian Society, the Protestants United for a Separation of Church and State, and the National Council of Churches, is on the list?

Mr. GREEN. Mr. Chairman, perhaps I can throw a little bit of light on it. But first, I want to say definitely that we have not had an opportunity as yet to go through the files to pinpoint why a particular organization was included in the list. However, I can make this statement; and while I had no part in drafting the response which you have in question here, but I do think that in the category two, non-violent groups, I know personally of situations where organizations that would fall within that category—some elements of the organization were sympathetic to some of the causes of the more activist groups, and through various methods, arrangements were made to fund, or to transmit funds, from that organization into these activist groups.

Now, I am not saying at this time that any of the organizations that you mentioned—because I cannot say it categorically one way or the other, that they did or they did not—but I do know that some of the organizations did have these types of arrangements, and our interest in that aspect of it would be to determine if that activity were of sufficient magnitude and sufficient importance in the overall operations of the organizations, to have an adverse effect on its exempt status. I would like to state that the mere existence of those three lists did not, at that time, and should not, be interpreted now that the Internal Revenue Service had hard evidence of any nature on these organizations. I certainly hope—and without having had the opportunity to go through each of these files one by one—that there was some indication, or some question, that would justify, under the criteria that I have attempted to lay out, to justify their presence on any one of the lists involved, the 99 organizations.

And if I could make one more comment, Senator, that our review has been completed to the point, in looking back on these three inquiries, where the three lists were sent to regional commissioners—and I believe those are on the record—if you have those three letters, each one of them asked for information in very specific terms in an attachment; name and address of the organization, type of organization, tax return filing and payment history, and so on—a list of nine specific items.

When those reports—and incidentally, I might say at this time, I have not had an opportunity to look at all of those reports, but we can say this—when they were received by the staff, analyzed by the staff, it was determined that on 80 out of the 99, there was no basis whatsoever to take any further action with regard to the organizations; 80 out of the 99. On only 19 out of the 99 was there subsequent referral of the information to the appropriate field office for their consideration of whether to make any type of investigation in the normal conduct of the field office activities.

Senator HARTKE. Well, the memorandum which you referred to earlier, March 25, as I have indicated before this, will be a part of the record. On the March 25, 1969, memorandum, from Assistant IRS Commissioner Bacon, which provided the 22 original groups and organizations to be reviewed by what then was called the activist organization committee, the memo states, as I have said before, that this list was supplied by the Senate Committee on Government Operations. It refers to most of these groups, in the words of the memorandum, as newsworthy and controversial.

Now, is it your understanding that this list came solely upon the recommendation of the Government Operations Committee, and why does the criteria cited in your reply to the subcommittee appear to differ from the criteria which is cited in this memorandum?

Mr. GREEN. I am sorry, Mr. Chairman, but I cannot interpret it that it does differ.

Senator HARTKE. The criteria originally established were the three groups we said: The violent groups advocating revolution against the Government of the United States, nonviolent groups, and stated tax resisters. Those criteria are not in the memorandum at all. The criteria in the memorandum are—

Mr. SCHOENFELD. Senator Hartke, I think question 10 refers to the criteria—what we were just referring to were the broad categories and classifications of the organizations about which the special services staff had maintained files. We explained that there were no established criteria used by the special service staff for selection of organizations about which it gathered information, and I will quote from our reply. We say, "The usual standards for referring items from the field were employed. Such matters as the following were considered; failure to file required returns, failure to report all items of income, claiming of erroneous deductions or exemptions, or engagement by an organization in nonexempt activity." These were the criteria, Senator.

Senator HARTKE. Well then on July 14, 1969, a memorandum from Assistant Commissioner Bacon lists a second group; is that correct?

Mr. GREEN. That is correct.

Senator HARTKE. And that group had 55 organizations which were added to the SSS list?

Mr. GREEN. That is right.

Senator HARTKE. How were these organizations selected to appear on that list, and who had a part in the selection process?

Mr. GREEN. As I indicated, we have not had an opportunity to go into each specific file that the list states. However, it appears that this list, came from within IRS with one known exception—we do know

that one of the organizations listed in the 55 was a subsequent referral from Senator McClellan.

Senator HARTKE. Now that is a subsequent referral from him?

Mr. GREEN. From him to the Internal Revenue Service.

Senator HARTKE. Is that by written memorandum or by oral?

Mr. GREEN. That was oral, as I recall. That is my recollection.

Senator HARTKE. In other words, Senator McClellan orally called you and gave you an addition of another list of individuals.

Mr. GREEN. I would expect it was not Senator McClellan personally, but a member of his staff, but I would have to follow through on that to make certain, but our records do indicate that one—

Senator HARTKE. In other words, this initiative was in the Government Operations Committee of the U.S. Senate; is that what you are telling me?

Mr. GREEN. Yes, sir.

Now with regard to the other names on that list, we do not know at this point the specific reason they were included on the list, but I certainly know that the intention was—and I certainly hope we will be able to establish that either there was an indication that they were an activist organization to fit in the first category, that they were an organization which might perhaps be channeling funds into these activities to an extent that their exempt status might or might not be in jeopardy.

Senator HARTKE. All right. Now, then the third list on activities, 1969, was accumulated. Is that correct?

Mr. GREEN. That is correct.

Senator HARTKE. This is a memorandum, again from—well, let me ask you this—this third list of 22 organizations which were placed on the same list, the IRS list—

Mr. GREEN. October 8, 1969.

Senator HARTKE. That is an additional 22 to the original 22.

Mr. GREEN. That is right.

Senator HARTKE. And to the subsequent 55 and then 22. Am I correct on that?

Mr. GREEN. My comment on the 55, or 54 of the 55, would apply to the subsequent list of 22.

Senator HARTKE. All right, now who took part in that selection, and where did these names come from? How did they get on the list?

Mr. GREEN. Well, first I must back up just a little bit and make one distinction. The list, the second list, of 55 organizations—and this goes to our own organization at the time—was prepared in what we call our disclosure staff. This is an organization that had the responsibility for assuring that any disclosures of tax information were made only in accordance with the permitted provisions of the disclosure statute. In other words, so that no information was disclosed outside of Internal Revenue except that specifically authorized by the law.

Now the list of 55 was prepared in that staff, and at this point I cannot say for certain, but my belief is it was prepared there only because the activist organizations staff had not become fully operational, and the chief of the disclosure staff would have been involved and interested in this activity until the staff became fully operational. The list that was transmitted to regional commissioners on October 8, 1969,

was developed apparently within what was then known as the activist organization staff, but certainly it was our expectation and it is my belief that the criteria that I have attempted to outline here was utilized and utilized uniformly in preparing both of the lists.

Senator HARTKE. Is it your contention then that the three lists basically were all determined in accordance with the same criteria?

Mr. GREEN. No, sir. No, sir; because I cannot tell you what criteria the Senate permanent subcommittee utilized in developing the initial 22.

Senator HARTKE. Do you not know what they used in the initial 22?

Mr. GREEN. Any comment on my part would be—

Senator HARTKE. Was there not an apparent change of listings which occurred after that? In other words, the original 22 were groups which had been identified, publicly at least, in some of the activities to which you had previously referred as violent activities. When you come down to the place in the second list of 55, when they get the Americans for Democratic Action, and we get the National Council of Churches, and the Urban League, would you have indicated that those organizations were something which were especially significant to the Internal Revenue Service?

Mr. GREEN. May I confer with the Commissioner for just one moment, please sir?

Senator HARTKE. Yes.

Mr. ALEXANDER. Well, if we have anything to say, let us say it.

Mr. GREEN. I was just asking if the Commissioner thought it was appropriate to lay before the committee certain information that I do have relating to one of the organizations that you mentioned, that being the National Council of Churches. There was a spinoff organization of the National Council of Churches that apparently was sympathetic to the views and the activities of an activist organization.

We were aware of this information. We were interested in determining whether this organization, the National Council of Churches should be examined to determine whether that activity would have an effect on the exempt status of it or of any of its spinoff organizations.

Such an examination was conducted, and while it was established that these funds were being so routed, it was later concluded by the various activities of the Service that the extent was not of such magnitude that the exempt status of the National Council or of any of its organizations would be affected.

Mr. ALEXANDER. Mr. Chairman, as we get into these specific matters—and I can well appreciate your concern—may I suggest that we consider developing, as to which of these entities that deserves your concern and the concern of others, information as to why the entity was included, to the extent that those involved in this matter can recollect and what actually happened and present that to the Joint Committee on Internal Revenue Taxation in executive session as promptly as possible.

We are getting into a disclosure problem, Mr. Chairman.

Senator HARTKE. I hear what you are saying, but I am not as much interested at this moment in that aspect as far as this hearing is concerned. I am a member of the Joint Committee on Internal Revenue Taxation.

Mr. ALEXANDER. I know you are, sir.

SENATOR HARTKE. I am not talking about the specifics as much as I am at this moment going back into the overall procedures which were utilized here, because it is quite evident—and I think the testimony indicates to me—that the memo of July and August 1969, which announced the formation of this group, referred to its function of collecting information on “ideological, militant, subversive, radical, and similar type organizations,” and all of those terms depend upon a very highly subjective decision.

In other words, what might appear to be within the ideological concept of one individual might be completely different for somebody else, the net effect of which was to give to the IRS the responsibility of making decisions and investigating certain organizations and groups whose purposes or activities were not in accord with the position of those in high Federal office.

MR. GREEN. May I respond to that?

SENATOR HARTKE. And that specifically is the thrust of what I am talking about. I am talking about the politicization of the IRS for the purpose of even conducting an investigation. When you come down now to the question as to whether or not there was or was not an actual finding and what the decision was, you are dealing then with an entirely different proposition. But the mere threat of some type of investigation or the power of the IRS is certainly not one which is at this moment in the nation without some type of “courteous respect”—let me say it that way—and I put that in quotes.

MR. GREEN. Mr. Chairman, may I—

SENATOR HARTKE. Just a minute. What I am trying to develop here is the thesis behind this operation, the reason for it, and how it actually worked. I grant you cannot do that without individuals. Go ahead, which one of you wants to start?

MR. ALEXANDER. Well, Mr. Chairman, we will be glad to develop this with you generally.

As at the beginning of this hearing, we stated the importance of this issue to us and to you and to the country, as soon as the Joint Committee, of which you are a member, completes its investigation of the Special Service Staff, which I surely hope can be as promptly as possible, I hope that there will be a hearing on this matter, that there will be such legislative recommendations as the Joint Committee, the Finance Committee, and the Ways and Means Committee feel appropriate. I do request, urgently request, that Joint Committee continue a strong interest in the exercise of its authority and duty to perform legislative oversight over the Internal Revenue Service on a continual basis.

Mr. Chairman, I could give you assurances as to what the Service will do and what it will not do, so long as I am Commissioner. I cannot give you further assurances, except insofar as the career people before you demonstrate by their integrity and their independence that these assurances will survive me or any future Commissioner.

As to what will happen in the future, I think what happens in the future depends on constant vigilance, not only within the Internal Revenue Service to maintain its integrity and its independence, but constant, continual exercise of legislative oversight to make certain that its integrity is not impaired.

Senator HARTKE. I think that is a worthwhile statement, but the fact remains that when we come back to these documentations and look at them—we take on July 24, 1969, noting the work of the Activist Organization Committee, IRS filed a memorandum. It says “It is an extremely important and sensitive matter—now here are the words that I want to call to your attention—in which the highest levels of Government are interested.”

What is meant by the term “highest levels of Government”? Would that mean the White House?

Mr. GREEN. May I reply?

Mr. ALEXANDER. Yes.

Mr. GREEN. Mr. Chairman, that memorandum, which you have in question, was prepared by the gentleman who was then the chief of our disclosure staff, and as I explained to you earlier, he was responsible for administering the disclosure statutes.

Senator HARTKE. His name, would you like to put that in the record?

Mr. GREEN. Mr. Donald O. Viridin. In light of his responsibilities in the disclosure staff, he had a very keen and acute awareness and sensitivity to the hazards of illegal disclosures. His comments in that memorandum are expressed in very dramatic terms and not necessarily those terms that others of us who were in the organization at that time might have used.

But I would like to point out to the committee that there was valid reason at that time for maintaining a low profile of this Committee and its activities and for tight security on portions of its files.

Now I would like to elaborate on that if I may. First of all, and as we have already, I think, agreed, Mr. Chairman, that these were troubled times. There were very—

Senator HARTKE. Well every time is troubled times.

Mr. GREEN. I agree, but—

Senator HARTKE. You know, it depends on where your troubles start. You know, if you start out in the morning and your wife gives you coffee which burns your tongue, it is troubled times. I mean that is a subjective decision. I mean some people feel terrible about different things.

Mr. GREEN. Very true, nevertheless—

Senator HARTKE. I may tell you I feel very troubled that all the time this was going on that I did not know it was going on, and I am a U.S. Senator, and I am at least responsible to the people of my State for trying to keep them alert to what is going on in their Government, and I did not know it. I suspected something was going on, but I was told repeatedly there was nothing going on that I did not know about.

Well, it turns out there were a lot of things going on I did not know about. I do not think it would make any difference if I did, but go right ahead.

Mr. GREEN. I would go back to the troubled times because it was a peculiar troubled time in which there was much violence, civil disorders, civil disobedience, and I might say that at the time I was aware of the fact that within the ranks of the Internal Revenue Service, there were people who had some degree of sympathy for these causes.

Now I could demonstrate—hear me out, Mr. Chairman—at least we felt that this group of employees should not have concrete information



about what we had, what we were doing, for fear that they would relay it to the organizations, the very active organizations, and they in turn vent their anger on the Internal Revenue Service. Lord knows that enough anger is vented on Internal Revenue Service by the conscientious, legitimate taxpayers of the United States. Beyond that this organization had in its files classified documents from other agencies of the Federal Government, some classified, as I recall, as high as top secret.

Because of the very nature of their classification, we were required to maintain a certain degree of security over those files in terms of the physical facilities in which they were located.

Now my reaction to that memorandum is that it was overstated in terms of the secrecy. Now in terms of interest of the highest levels of Government, I can only assume, because I do not know what was in the writer's mind when he wrote it, but we were aware that officials in the Department of Justice were very interested in these organizations, and I assume, I can only assume at this point, that this gentleman, knowing who had legitimate interests in this operation were "at the highest levels of the Federal Government."

Senator HARTKE. Well, let me—

Mr. GREEN. But I might say that this gentleman, after Staff was organized, had no authority and no responsibility for the activities that were undertaken by the Staff itself.

Senator HARTKE. Well, in that same memorandum of July 24, 1969, on page 3, you state in article 5—not you state, but the memorandum states:

We do not want the news media to be alerted to what we are attempting to do or how we are operating because the disclosure of such information might embarrass the administration or adversely affect the Service operations in this area, or those of other Federal agencies or congressional committees.

In other words, is this not an almost direct admission, in July of 1969, that this was an activity in which the IRS should not normally be engaged? And yet it took 4 years to abolish the Special Services Staff.

Mr. GREEN. No, sir, because the writer of that memorandum was not in any position in which he had the authority to make a decision, whether it was or was not appropriate or legitimate activity of the Service.

Senator HARTKE. Well, let me ask—

Mr. GREEN. I think the memorandum, the statement that you have read is most unfortunate. I do not think it reflects the views, necessarily, of others of us who were involved at that time.

Senator HARTKE. Well, let me ask, did not anyone at that time realize in the IRS that this was in effect a politicization of the IRS?

Mr. GREEN. Mr. Chairman, I do not view this as political, or whatever the word was.

Senator HARTKE. Well, using the IRS for political purposes.

Mr. GREEN. I do not view this in any way as using the IRS for political purposes. I can state before this committee without any equivocation whatsoever that at no time was I aware of any contact from the White House regarding the establishment of such an organization or any of the activities that went on within that organization, and in no

way in my view at that time was this an activity that was directed by the White House.

And going back to the comment that you made earlier, Mr. Chairman, to those of us that were there at that time, it made absolutely no difference what the political leanings, whether they were in favor of the administration or opposed to the administration. Our only interest was what they were doing, and did what they were doing have any bearing on whether they were or were not a tax-exempt organization and whether they were or were not subject to income tax on the funds received by the organization, and indeed there was good reason to suspect at that time, in some of these organizations, persons closely connected with them, were receiving personal benefit from some of those funds, not being used for the stated purpose of the organization.

As violent and as disagreeable as they may have been, there was evidence that some of the individuals were using the money for their own personal benefit, and if that were true, and if we could establish that that were true, those individuals would have been subject to payment of income tax on the funds so used, and that was another thrust of this organization.

Senator HARTKE. But that is true no matter whether you have troubled times or not, is it not?

Mr. GREEN. Oh, absolutely, absolutely.

Senator HARTKE. All right. In other words, whether we have troubled times or anything else, that is true of every organization. But now is it not true that there was a memorandum from the White House, a staff member Tom Charles Huston, to Assistant to IRS Commissioner Roger Barth on August 14, 1970? They said at that time that the White House was interested in the work of this group and had been interested in it as far back as February or March of 1969.

On what date did the Service first receive contact from anyone at the White House on the need to give special attention to the activist or ideological organizations?

Mr. GREEN. Mr. Chairman, I can speak only for myself. I can say, as I said before, categorically, I was never aware of any contact with anyone within the Internal Revenue Service regarding the White House desire for this type of an operation, this type of a staff, this type of an investigation. Absolutely, if there was one, I was not aware of it. I am convinced in my own mind, as of this day—and I speak only for myself—that those with whom I was closely associated at that time in the establishment of this staff, had no such knowledge themselves. But they would have to so state themselves.

Senator HARTKE. This is exhibit No. 42 in the Presidential campaign activities of 1972, S. Res. 60, commonly called the Watergate hearings. It is from Tom Charles Huston in which he said:

Nearly 18 months ago the President indicated a desire for IRS to move against leftist organizations taking advantage of tax shelters.

I have been pressing the IRS since that time to no avail. What we cannot do in a courtroom via criminal prosecutions that curtail the activities of some of these groups IRS can do by administrative action. Moreover, valuable intelligence-type information could be turned up by IRS as a result of their field group audits.

Now do you not feel that that was an attempt by the White House, at least, to use this group for political purposes?

Mr. GREEN. If such contacts were made for illegal purposes, depending upon the use that the White House was making of it, yes. But I can only state that if such a contact was made or if more than one contact was made, it was never relayed to me and I was very instrumental in setting up the Activist Organization Committee, later known as the Special Services Staff.

Senator HARTKE. Well, then on August 14, 1970, there was a memorandum to Roger V. Barth, Assistant to the Commissioner of IRS, and the subject was "ideological organizations," a very short memo:

Could you give a progress report on the activities of the Compliance Division reviewing the operations of ideological organizations? I would be interested in knowing what progress has been made since July the 1st, 1969, when we first expressed our interest in this matter.

And that is again from Tom Charles Huston.

Are you telling me that this is an indication that nothing was happening, that there was not this type of activity?

Mr. GREEN. I did not say that, Mr. Chairman. I said if it was happening, I was not aware of it, and I am convinced in my own mind that those—and I am speaking now of the Assistant Commissioner of Compliance and those of our staff who engaged in setting up this organization—were not in any way aware of, advised of such a contact from the White House.

Now I will—

Mr. ALEXANDER. Mr. Chairman, about this particular memorandum of Mr. Huston, I believe this is one that you and I discussed on June the 3d and reviewed in pages 153 and 154 of the record of that hearing. I think that Mr. Huston stated that he found IRS' 1970 response to be long on word and short on substance. I expressed my pleasure with his displeasure at the June 3 hearing. I would just like to reiterate my pleasure that he found, that Mr. Huston found, us to be short on substance.

I think the question, one of the basic questions we have here, is the tension and the friction between IRS' responsibility to administer the laws, including section 501(c)(3) of the Internal Revenue Code, which denies exemption to organizations carrying on propaganda or engaged in the political process, and IRS' duty to administer this provision of the law as well as all other provisions completely evenhandedly, without regard to which side of the political fence the organization is on, without regard to what cause it may espouse, but with regard only to whether the organization is entitled to the exemption which it is seeking or which its contributors are claiming.

Now that difficulty—sure, these are difficult times and those were difficult times. We will continue to have difficult times as long as the IRS is charged with the responsibility of administering the Internal Revenue Code, including these provisions, it is going to have to do its utmost to exercise that responsibility evenhandedly and carefully and well.

And for that reason, Mr. Chairman, down before you we have the whole group of new Assistant Regional Commissioners who are going to have field responsibility for our employee plans and exempt organizations work, because I wanted them to hear the concerns of this subcommittee this morning as to how the IRS should conduct itself in an area that is fraught with emotions and with problems and with misunderstandings.

Senator HARTKE. Once an organization was placed on the list to be given special attention by the SSS, what would happen? For example, were its tax returns automatically audited?

Mr. GREEN. Absolutely not, absolutely not. I think the Commissioner referred a few moments ago to the number of files that were ultimately accumulated in this organization and frankly, the figures escape my memory at this particular moment. I do believe that the Commissioner has the figures on the number that were referred to field offices for consideration. The staff had absolutely no authority to direct, supervise, require, any investigation of any organization or of any information that might have been submitted to a field office.

The information was referred to a field office for their consideration independently of whether the information was worthy of further consideration, further investigation. They had full authority to close it to their files without any action. But the number that was referred to the field was relatively small in the total picture.

Senator HARTKE. How many of those organizations were audited?

Mr. GREEN. At this point I cannot tell you exactly. Now, excuse me, of these on the first 99?

Senator HARTKE. Right.

Mr. GREEN. As I indicated previously, Mr. Chairman, 80 of those organizations, after information was received, analyzed, it was determined that there was no question, no indication, of any evasion or avoidance of tax responsibility, no further need for consideration. Those files within the staff were closed and given no further consideration.

Of the remaining 19, information was referred to field offices for further consideration in the judgment of the receiving office.

So out of the 99, only 19 were subsequently referred back to the field offices with information accumulated by the staff for possible further action.

Senator HARTKE. But in other words, you are telling me then that only 19 were audited.

Is that what you are saying?

Mr. GREEN. No; I am not saying that they were audited because there are various actions. There is collection action, there is audit action in terms of whether the organization is exempt or not exempt. In some cases there is no record of the organization having filed any type of return, not having exempt status, evidence of them having received income. This information would be sent to the field for consideration of whether they should make an investigation to determine is this organization exempt or should this organization file a taxable return. That type of an investigation.

Senator HARTKE. All right. These organizations—were any of the requests for rulings from IRS which have been initiated by that organization given any special attention?

Mr. GREEN. There was a procedure established within IRS to coordinate between this information in the files of the Special Services Staff in connection with applications for exemption pending in the office of the Assistant Commissioner-(Technical) within the national office. And I do not recall that we have specific information on the re-

sults of those referred, but in most cases there would be some delay perhaps, and this would result in some additional delay for the Assistant Commissioner (Technical) to review and analyze the information submitted to him and to determine whether this information might have a bearing on the exempt status of the applicant.

Mr. ALEXANDER. Mr. Chairman, we would be glad to supplement the testimony here by submission for the record.<sup>1</sup>

Senator HARTKE. All right. We have some other questions which I want to submit to you for the record, too, and we will give those to you.

Mr. ALEXANDER. I hope you are going to give me a chance to explain one thing you explained in your statement a few minutes ago.

Senator HARTKE. You can explain anything you want to.

Mr. ALEXANDER. I know we are running out of time but your statement dealt with time. It dealt with the time for us to respond to the inquiry made of us by Mr. Robert Branden. I would like to have an opportunity, Mr. Chairman, to explain that very briefly to you.

Senator HARTKE. Go right ahead.

Mr. ALEXANDER. I am going to ask Mr. Willsey to explain it.

Mr. WILLSEY. During the period of time that Mr. Branden's request was pending with the Internal Revenue Service, we were also discussing with Senator Ervin's Subcommittee on Constitutional Rights the extent to which that subcommittee and its investigators would be given access to the complete files of the Special Services Staff. Many of the documents, such as you have before you, contain specific names of taxpayers, specific identification of activities relating to specified taxpayers or tax entities. Also, at that same time, much of the material in our files was given to us by the FBI with the strict admonition of maintaining its confidentiality within the Internal Revenue Service.

During the period of, I think approximately the first 6 months of this year, I met a number of times with Senator Ervin's staff giving them information, giving them the complete material that we could give them, without running afoul of the antidisclosure provisions of the Internal Revenue Code.

At that same time I personally was responsible for having our lawyers discuss the question of whether we would start down the road of disclosing any of the information that Mr. Branden had requested, whether we could appropriately disclose any of that information, and where ultimately the disclosure of the initial parts of that information would lead us.

When we resolved the question with the Attorney General of whether the FBI was going to permit us to let the Senate investigators have access to the files, once that decision was made we also decided to go through the files at that time and make available the information that Mr. Branden had requested and excise from that information the materials relating to specific taxpayers.

In other words, during this entire period of time there were two related—actually, three related investigations going on. We felt, or I felt, that it was inappropriate to respond to private litigants or to private requesters for information until we had determined the extent of our responsibilities to the Senate Subcommittee on Constitutional

<sup>1</sup> See app. D, p. 335.

Rights, and also, while we were coordinated with the Joint Committee on Internal Revenue Taxation on the investigation.

Senator HARTKE. Well, all right. Let me ask you, though, on the procedures again, was the exempt status or the application for exempt status by any of the groups which were on the list affected in any way by its presence on the list?

Mr. GREEN. Not by its presence on the list, absolutely not.

Senator HARTKE. Well, did the—

Mr. GREEN. If there was any influence at all, it would be on the basis of specific information contained in our files at the time the application for exemption was being considered by the Assistant Commissioner (Technical). The mere presence of a name on the list has absolutely no meaning in that context at all.

Senator HARTKE. I can see where you can say that, but how can you even—

Mr. GREEN. The mere fact that the name was on the list—

Senator HARTKE. The mere fact the name would be on the list and not affect their exempt status, except that their exempt status may have been affected as a result of their name being on the list.

Mr. GREEN. Absolutely not.

Senator HARTKE. Is that a fair statement?

Mr. GREEN. No, sir, because the Assistant Commissioner (Technical) does not care what kind of list we maintain. He would be interested only in the information that is available to him from whatever source, including the special services staff, regarding the activities of that organization, the utilization of the funds flowing into that organization, and this type of thing.

Senator HARTKE. Well, did individuals who were connected with any of the organizations receive special consideration from the IRS?

Mr. GREEN. Could you elaborate on special consideration?

Senator HARTKE. In other words, were individuals who were connected with these organizations, were they given special consideration by the IRS?

Mr. GREEN. Only to the extent that we might have evidence that the individual was receiving income subject to income tax and either had not filed or if he had filed, had not reported that income.

Mr. ALEXANDER. Mr. Chairman, the Joint Committee staff has had an opportunity in its truncated initial examination (because the FBI would not let them look at the files at that time) did, however, have a chance to check out individuals about whom referrals of information were made by the special service staff, and this is what they said:

The Joint Committee staff, however, has found no evidence that individuals about whom referrals of information were made by the SSS to the Audit, Intelligence and Collection Divisions were treated any more harshly by these divisions than was normal.

I do not know what they mean by normal harshness. Then they go on to state:

Indeed, in some cases the IRS seems to have been more lenient than normal with prominent extremists, perhaps in order to avoid the charge that radicals were being persecuted.

Senator HARTKE. Let me ask you, did any organization lose its exempt status that was on the list?

Mr. GREEN. I have reason to believe—oh, by virtue of being on the list.

Senator HARTKE. Well, I would just ask—

Mr. GREEN. I want to draw a distinction.

Senator HARTKE. I will just ask did any of the organizations on the list lose their exempt status?

Mr. GREEN. I think there were one or two. I would prefer that we accumulate the information.

Senator HARTKE. Do you want to submit that for the record?

[The following comment was subsequently submitted for the record by the Internal Revenue Service.]

None of the organizations on the three initial lists of 99 organizations lost their exempt status as a result of being on the list. No referral to the field was made by the Special Service Staff with respect to 80 out of the 99 organizations. Of the 19 organizations which were referred by the Staff to the field, one organization failed to establish its exempt status during the period after the referral. In years prior to the creation of the Staff 5 other organizations, which later were included in the 19 referrals to the field, either lost or failed to establish their exempt status.

Mr. ALEXANDER. Again, this is information we can supply later. To the extent that supplying this information is permissible within the statutes limiting disclosure, it is information that we would be delighted to supply to the Joint Committee staff and to the Joint Committee itself, which, Mr. Chairman, of course both Senator Curtis and you are members. I would be surprised if, considering the large numbers involved, that some of the organizations did not have their exemption questioned. Certainly, we have an obligation to inquire as to whether organizations are entitled to the exemption they claim. We have fulfilled that obligation in the past and we intend to in the future in connection with this expanded audit program that I described.

Senator CURTIS. Would you yield right there, Mr. Chairman?

Senator HARTKE. Yes, I would be glad to yield.

Senator CURTIS. Let us have the record clear. No group or organization lost its exempt status because its name was on this list.

Mr. GREEN. Absolutely not.

Mr. ALEXANDER. No.

Mr. GREEN. Absolutely not.

Senator CURTIS. But if there were facts justifying the removal of a group's tax-exempt status, the action was based upon those facts and no weight given to the fact that its name was on the list.

Is that not right?

Mr. GREEN. That is the point that I had hoped and was attempting to get it across. You do it much more effectively, Senator.

Senator CURTIS. I think you gentlemen are a little bit too apologetic for what was done here.

Mr. GREEN. Senator, I in no way am apologetic. I would like to say that.

Senator CURTIS. I do not mean that critically. I mean you have handled a difficult problem and have done it well. You should be required to answer for what was done, not what somebody on the outside or somebody in any other Government office is talking about. But your responsibility is to what the Internal Revenue Service did, and I sup-

pose there is no perfect operation. But I have come up with no evidence whatever of any wrongdoing or wrong motives in this area.

I think that the Service has handled these matters on the basis of what the facts are and then taken action that has been applied to people, to all citizens alike.

Mr. GREEN. Mr. Chairman, could I clear up one point at this point?

You indicated earlier that you had great admiration for Commissioner Alexander and what he has done since he became Commissioner.

Senator HARTKE. Right.

Mr. GREEN. I could not agree with you more fully.

Mr. ALEXANDER. That may be an overstatement but, if so, I still welcome it.

Mr. GREEN. In the press recently the Commissioner has received a great deal of criticism, and I want to focus on one point of that criticism, to the point that, as I recall, it has been stated that he lied when he said that there was no White House influence in setting up this staff by virtue of, number one, the memorandum which you read awhile ago from Mr. Huston in the White House to Mr. Barth referring to a contact with Mr. Barth between the two on July 1, 1969, and a meeting which is in the record on July 2 on which the activist organization staff was organized.

Earlier in my testimony I attempted to explain to you, going back into 1968 and the interest of the Senate Permanent Sub-Committee on Investigation. My testimony before that group on June 25, 1969, and my recommendation that this staff be organized, the coincidence, and it is nothing, as far as I am concerned, it is nothing more than a coincidence that there was or is alleged to have been a contact of Mr. Huston with Mr. Barth on July 1, 1969, a meeting held on July 2, 1969, setting up this organization. I was a part of that action and as I have said previously, I was in no way aware of any contact from the White House to anyone within the Internal Revenue Service.

The action to set up that meeting on July 2 had to have been taken prior to July 1. We just do not set up meetings generally that fast to discuss a subject of that type.

So I would like for the record to clearly show that the Commissioner did not lie, as he has been accused of, and I think it is a tremendous tragedy to a man as dedicated to this organization as he is.

Senator HARTKE. But you will have to admit it is a rather unusual coincidence.

Mr. GREEN. A very unfortunate, not unusual, a very unfortunate coincidence.

Senator HARTKE. It is a coincidence. On July 24, in your letter to the subcommittee you noted that for the calendar years 1969 through 1973, that the Assistant Attorney General of the Internal Security Division of the Department of Justice made 99 requests for information collected by the SSS.

Now is it also coincidental that your figure of 99 corresponds with the number of organizations which were placed on the list of the SSS?

Mr. GREEN. I am sorry. I am not prepared for that question.

Mr. ALEXANDER. The question deals with the fact that there were 99 organizations originally on the list and the statement that the Assistant Attorney General for Internal Security made 99 requests, and the purpose of the question is whether it is the same 99.



Mr. GREEN. I cannot answer that question, Commissioner.

Mr. ALEXANDER. Can you, Howard?

Mr. SCHOENFELD. We will have to supplement that. We only relayed them, the numbers of requests that were made. I am not aware that anyone looked to the names of the organizations that were the subject of the request. We can do that and we can get back to you, Senator.

Senator HARTKE. Well it is just coincidental, then?

Mr. SCHOENFELD. I believe so, yes, sir.

Mr. WILLSEY. Yes, sir, it is completely coincidental.

Senator HARTKE. They are not the same organizations?

Mr. WILLSEY. No, sir.

Senator HARTKE. None of them are the same?

Mr. WILLSEY. I am not sure that there are none that are the same but they are not the same lists of organizations.

Senator HARTKE. Could you supply that so we could go ahead and review that and see whether or not we have a coincidence?

Mr. WILLSEY. Yes, sir, we will supply that.

[The following comment was subsequently received from the Internal Revenue Service:]

Only two of the organizations named in the 99 requests for information from the Assistant Attorney General, Internal Security Division, were organizations on the three initial lists used by the Special Service Staff.

Senator HARTKE. You know coincidences have a peculiar way of becoming convincing after awhile.

Mr. GREEN. May I respond to just one statement there, that I think I can say without any reservations that at that time no one within the Internal Revenue Service had information about activities that were obviously, or apparently may be a better word, transpiring within the Federal Government. That information did not, as I recall, come out until a much later date.

What I am trying to say is that I do not believe that at that time anyone within the Internal Revenue Service or certainly no one within the part of the organization with which I was associated, would have viewed with any skepticism a request from the Assistant Attorney General with regard to 99 names.

Looking back, maybe we should have.

Senator HARTKE. In the August 9 statement, Commissioner Alexander, which you issued in 1973, announcing the abolition of the special services staff, you were quoted as saying, "The task now being performed by the Special Service Staff can be handled efficiently by other components of the Service as a part of their regular enforcement activities."

And then on August 15, 1973, an IRS memorandum of understanding states that a task force would be created to phase in SSS files into the regular IRS activities.

Has this task force completed its work?

Mr. ALEXANDER. I will respond generally to that and I am going to ask Mr. Willsey to respond specifically.

On August 9, when I terminated the SSS, it was my understanding that the work presently done by that group involved tax resisters and tax protesters. It involved the collection of information and the transmission of information with respect to them to field offices.

Now the Internal Revenue Service had and has and will continue to have the responsibility of enforcing the tax laws, and if someone is engaged in trying to defeat the administration of the tax laws, we have had and will continue to have an interest, as we must have, in that person and in making sure that that effort does not succeed.

This is brought up very clearly in better words than I can state in page 16 of the joint committee report of last December.

Now a task force, without my participation, set about to disband the special service staff, transmit whatever files and information were necessary to transmit in the wise administration of the tax laws to the proper recipient agencies. And Mr. Willsey, although he was not a member of this task force, was advised, not as early as probably he should have been advised, but from time to time, about the activities of this task force, what it has done and what, if anything, remains for it to do.

Mr. WILLSEY. Immediately after the Commissioner's decision to abolish the staff, the question came up of what should be done with the materials that the staff had collected. I personally met with members of the staff and their superiors and discussed with them the kinds of information that the staff had in its files.

At that time I was assured by members of the staff that there was indeed a great deal of information in the staff files relating to the failure of different organizations or individuals to meet their tax responsibilities. And secondly, a great deal of information relating to persons who were actively encouraging others to disobey or disregard the tax laws.

Pursuant to our discussion at that time, I authorized them to review all of the files that were in the Special Service Staff to determine which of those files actually contained the kinds of information that I was informed was there. They met, as I recall, with representatives of other components of the Internal Revenue Service who would have particular responsibility.

For example, if an organization had not filed tax returns they would meet with the Collection Division, the component of Internal Revenue Service which would be responsible for actually securing the return for the period in question. Or, if a person was actively engaged in recommending disobedience of the tax law, depending on the type of disobedience, it would be referred either to our Inspection Division or our Intelligence Division.

After several meetings of this group I was informed that they had made some preliminary decisions concerning dissemination of the information, distribution of the information within the files. There, as I recall, were probably four or five meetings of this group during this period of time.

After the conclusion of the final meeting, I was told that they had evaluated the information in the files and determined which component of the Service should have them. In fact, however, at that time we were approaching the end of the year and I had given them definite instructions that this complete activity had to be completely terminated by the end of the year—not the activity but the determination of where people were going to be assigned, things of that sort.

At that time, and I have been informed as recently as yesterday, no dissemination whatsoever of the file material themselves was made

outside of the Special Service Staff. Those files were maintained in complete integrity within the Special Service Staff file room which is under a combination lock. Those files are still there and will be maintained there and only there until such time as the committees having responsibility for investigating the staff's activities have concluded.

At that time, as Commissioner Alexander has suggested, we will make suitable disposition of the file material.

Now I am informed that during the period of the phasing out of the staff's activities, there were referrals made to the field of a number of specific tax protesters which, at that time, was what Commissioner Alexander and I were informed was the basis for the group's continued existence. Those referrals to the field were made of individuals or organizations who were actively engaged in resistance to the tax laws.

I have been informed that that was the sole dissemination of any information that has been made out of those files and they were just referred to the field for whatever action the field felt was appropriate.

Senator HARTKE. What you are saying in substance, then, is that really, the disbanding of this organization has not been completed.

Mr. WILLSEY. Yes, sir, the disbanding of this organization has been completed. The only thing that is maintained is the staff files. I think only two people have the combination to the staff file room. The files are being maintained solely for the limited use of the Senate investigators, or the joint committee investigators, who have responsibility for examination of the staff's activities, solely for the purpose of letting them complete their investigations.

Senator HARTKE. I have some more questions, Commissioner, which I am going to submit now on the same line. But I will put those in the record for you.<sup>1</sup>

I want to come to the general subject; in the coming year, will IRS devote more attention to public charities, that is to the groups which send out mail solicitation for money, for instance?

Mr. ALEXANDER. Mr. Chairman, yes. We do intend to devote more attention to public charities. As you know, we are redesigning our forms 990 and 990 PF. Last year, we put a question on the form calling for information to be supplied as to the cost of fund raising. We are redirecting the emphasis in our audit program. We are engaged, as I mentioned earlier, in a taxpayer compliance measurement study in this area. We think it is long overdue. It will include not only private foundations, but other 501(c)(3) organizations, as well as 501(c)(4) organizations.

Under the leadership of Mr. Lurie, we intend to have a strengthened, and broadened effort in assimilating information, in making that information available to the Congress and to the foundation and exempt organization communities, and in seeing to it that these very difficult responsibilities of ours to assure compliance with the tax laws are met.

Senator HARTKE. Have you at this time discovered what you consider inadequacies in the tax law itself which should be corrected?

Mr. ALEXANDER. Mr. Chairman, of course, the Treasury speaks on tax policy matters through the Secretary and the Office of the

<sup>1</sup> See app. D, p. 338.

Assistant Secretary on Tax Policy, Mr. Hickman. And he has supplied answers to questions 8 and 9 in your letter to me. Speaking purely from a personal standpoint, Mr. Chairman, we are faced in some areas with an all-or-nothing approach. In some areas, we do not have the legislative authority to assist the offending organization to get back on the road to righteousness. Instead, the tool available to us is actually a weapon. It is a weapon of taking away the exemption of the organization and disallowing contributions to the organization.

Now that, I suppose, has a therapeutic effect. But it also has a killing effect. Chapter 42, dealing with private foundations is a legislative thrust in the other direction, toward correction, rather than toward overkill. That is one problem that I can see. Another problem is the lack of a direct route to the courts for a charity. That question, or that issue, has been remedied in the recent Employee Retirement Income Security Act, by permitting a pension plan or a profit-sharing plan, to test our decision as to whether it lacks qualification.

We would hope, as I have testified before you and before others, that that same direct right to go to court to test our action would be extended to charitable organizations, so that these delays which concern the subcommittee, and which concern us, and which concern the exempt organization community, would not occur.

Senator HARTKE. Well, in regard to these specific areas, and any other areas in which you anticipate you might have some suggestions for legislative change, I would hope you would submit those to the subcommittee, and that we could have them in sufficient time to deal with them in the first part of next session.

Is that possible?

Mr. ALEXANDER. Mr. Chairman, again, the Treasury speaks on tax policy matters.

Senator HARTKE. I understand.

Mr. ALEXANDER. As you know, I think that the views that I have just outlined as being my personal views are shared by the Treasury policy-makers. We will do our best to meet that deadline.

Senator HARTKE. What is the Internal Revenue Service doing now to expand cooperation with State officials who are responsible for administering exempt organizations?

Mr. ALEXANDER. I would like the former State official, Mr. Chairman, that I introduced earlier, and who will play a prominent part in our new organization, to respond to that question. Mr. Rumph, could you respond?

Mr. RUMPH. Yes, sir.

Mr. Chairman, I think the two principal areas in which I felt there were gaps in cooperation between IRS and the States when I was on the other side of the organization were in the type of data that the IRS can provide to States, and the time it can be provided, as one principal area; and the other in some kind of understanding about the kind of examination that is conducted by IRS in carrying out its function, and the type conducted by the State. Let me talk about those two for just a moment.

The Service operates under strict statutory limitations about the type of data it can make available to a State. And what occurred too many times was that in the time it took IRS to complete an audit, to recommend some kind of adverse action (which is the only trigger for

providing data directly to the State) oftentimes the money was gone, the trustees had disposed of it in other ways, and the Service's concern then might come back to income tax ramifications for the individual trustee rather than the loss to the public. So, there have been some significant steps made to change this situation.

For example, in a manual supplement issued about a year ago, the Commissioner determined that in a particular case where the Service came across facts that would seriously jeopardize the assets of a particular organization, that even prior to some kind of adverse final determination, it could, in a very limited way, inform the State of that fact. Now, as you know, the State is the only entity with the equity jurisdiction to protect the public. The Service does not have that kind of authority, and that manual supplement was a significant step. I am satisfied that that policy is being carried forward now. That, of course, is a matter of timing, because if the State attorney general is not informed of the facts, he certainly has no opportunity to move quickly.

Unfortunately, we have only about six, maybe eight, States that carry on any kind of active exempt organization enforcement, and I think the public is fortunate that, about 50 or 60 percent of the important organizations, the large exempt organizations, are within the States that do have active programs. We feel that that, however, is certainly not an acceptable or desirable situation. We are concerned when a breach of trust occurs in a State where there is no program, since we originally issued a ruling that makes the organization that perhaps is carrying on the abuse exempt. We are examining what are our responsibilities as the original granting entity. We wonder how the public in that particular State is going to be protected at that point, and we think we may have some recommendations about where some solutions may lie.

At this time, the Service is concerned in its audits solely with assuring, as has been stated here on numerous occasions this morning, that the organization is complying with its original grant, grant being the terms set out in its exemption application. How far the Service should go into the typical financial inquiry, which the States ordinarily conduct, is still open to question. Even if we are limited in the extent to which we could make that information available to the public, that is to the State attorney general who then is empowered to protect the public, there are several steps that we think can be taken. Some of the most visible and obvious abuses, and the ones that are the most corrosive to the public's confidence in charitable giving, occur in the public charity area. Many of them are interstate fund-raising appeals, some of them carried on by religious organizations as well as other kinds of charitable organizations. We are trying to see if there is some kind of early warning system in which both the States and the IRS can participate, at least to inform the public or take the appropriate steps to protect the public at the very outset.

We were interested in the preliminary report of the task force that was studying the Internal Revenue Service as part of the Filer Commission study. It proposed some kind of disclosure statute, in the nature of the SEC statute, in the field of charitable fundraising. We certainly are interested in that and would have a role to play there.

One other area with which we are very concerned (we do a limited amount of this now and hope to expand it) is training. It has been the practice for the Service in the past when it conducted its training

courses at the various centers throughout the United States to invite the State attorney general of that State, on a space-available basis, to send his auditors or other field personnel to participate when we train our own exempt organizations specialists and analysts. We think there is a lot of room for that idea to expand. We think that that may be perhaps the best service we could provide in a State where there is no active program to enforce charitable trusts. We, in effect, would say to them, we will give you basic training for your auditors at least in what the Internal Revenue Code requires in this field, and provide you any expertise that we have.

Senator HARTKE. You made this computerized change, Mr. Alexander. How soon can we expect any real, significant followup data out of the new changes you have made in that field? In other words, one of the real problems is, as we have exchanged our views here, you have not been able to give us information we have requested.

Mr. ALEXANDER. That has been a real problem, Mr. Chairman. We explored that one last time.

Senator HARTKE. The fact is, it is still unavailable. You put in the new computer. In fact, how soon can we expect something concrete?

Mr. ALEXANDER. We are going to have some of it for you within a few weeks. To what extent we can shorten that time, I do not know. Some of it involves the sampling process that we are engaged in right now with Mr. Marlowe of your staff, Mr. Chairman. Mr. Rumph, could you give any further predictions as to time?

Mr. RUMPH. I think we are talking about information that will be found on the 1974 return, and the schedule we have been promised by the data processing people in the Service is July 1, 1975, to begin to input data from the calendar year 1974 filers whose returns are due on May 15. And on July 1, we are told they would be able to begin processing those returns into a master file that will be expanded, in some respects, 100 to 150 percent. Now, if they can start putting it in around July 1, with anywhere from 6 to 8 weeks required for processing, we should say September 1, September 15, hopefully.

Mr. ALEXANDER. We have said September 1, and we hope we can meet that commitment. Page 2 of this submission that I made to this committee this morning deals with the expanded base that we will have for the 1974 returns. Some of the information you have requested, of course, is information to be taken from material that we now have, like the answer to question 1 that you raised in your letter.

Now, that information is what I hope that we will have in your hands in a couple of weeks, the information that you have requested that can be assembled from data that we now have, as contrasted with the data that we expect to get with our expanded programs, taking into account the concerns that you expressed earlier this year, Mr. Chairman.

Senator HARTKE. The last question I have for you; you have a new assistant commissioner under the new pension law, the Assistant Commissioner for Employee Benefit Plans and Exempt Organizations and it is scheduled to take effect, I think, on December 2. Now, have you asked for the full appropriation for the authorization of \$76.6 million for that office during the current fiscal year?

Mr. ALEXANDER. Mr. Chairman, we discussed this issue, which is raised in questions 10 and 11 of your letter, in our submission. I find that we are requested by the Office of Management and Budget, which has not yet ruled on our supplemental for 1975 and our appropriation for 1976, to refrain from discussing this matter specifically until they have had an opportunity to approve or disapprove our request. I can speak generally to this issue, however. We have requested a substantial additional allocation of resources here. We hope that they will be sympathetic to that request, despite the budgetary considerations and restrictions that are now facing the IRS, like all Federal agencies.

Senator HARTKE. Let me say in that regard that I have instructed the staff to have the Congressional Research Service provide for the Senate Finance Committee an opinion as to whether or not the Finance Committee is entitled to that information as to the budget request of the IRS.

I want to thank you gentlemen for coming. I will have some more questions for you before we get through with these extended hearings.

Mr. ALEXANDER. Thank you, Mr. Chairman.

Senator HARTKE. All right.

[The prepared statement of Mr. Alexander follows:]

PREPARED STATEMENT OF DONALD C. ALEXANDER, COMMISSIONER OF  
INTERNAL REVENUE

Mr. Chairman, in your letter of November 6, 1974, you outlined some 13 areas of interest to the Subcommittee in these hearings. This statement will supplement the information conveyed in my response of November 19. In order that the record will be complete, I will review that response briefly and add some comments.

*Question 1*

In our preparation for these hearings, and specifically in preparing our response to Question 1, we discovered last week that a significant processing error has occurred which affects the data we provided to you on October 2 concerning the assets of private foundations.

I greatly regret that this happened and that the figures previously supplied are wrong. I am satisfied, however, that we have isolated the error and I have instructed the data processing staff to go beyond the immediate error and to test the entire master file as it relates to private foundations. I expect that report within two weeks, and I will immediately convey it to you along with revised figures.

*Questions 2 and 6*

We have previously informed you that the answer to the first part of Question 2 is in the affirmative. The inquiry in the second part of Question 2 parallels the request in Question 6. The base figure to which you refer both in Questions 2 and 6 is found on line 5 of part IX of the Form 990 PF. As I informed you in my letter, that line item has not, until this time, been transcribed from the 1974 Forms 990 PF into the master file. Until that data is available, we propose to sample 7,000 returns for years 1972 and 1973. We estimate that this will require approximately 90 days to complete. Work on that analysis will commence immediately.

Because the line item with this data will be transcribed from the 1974 Forms 990 PF, we will be able to produce a comparable 1974 figure from the master file. The Exempt Organizations Master File is being completely redesigned and will be prepared to accept input on July 1, 1975. We will be able to extract a 1974 total from line 5 for at least the calendar year filers as soon as the returns from that group are processed. Because this activity is getting the highest priority in the new organization, I think I can predict that the information should be available by September 1, 1975.

**Questions 3, 4 and 5**

In my prior response, I expressed serious reservations about our ability to perform the analysis requested in Questions 3, 4 and 5 within practical limitations of manpower and cost. The problem is inordinately complex because the precise information is found on returns other than the Form 990 PF of the particular exempt organization. I attached to my written response a description of the steps involved in obtaining this data and we have extended to Mr. Marlowe of your staff an invitation to sit down with us and try to arrive at some solution.

**Question 7**

To summarize my response to Question 7, we are selecting a scientific sample of the 4,935 private foundations which we recorded as having terminated since January, 1970. We are in the process of identifying the sample and will provide a list of the specific files to be reviewed to the appropriate key district where that file is located. We have prepared a form to collect the information you request, and, because of the relatively small number involved, we should have this data for you within a matter of weeks. Again, we invited and will welcome comments from Mr. Marlowe on our proposed form.

**Questions 8 and 9**

A copy of your letter and a request for a response to Questions 8 and 9 were sent to Assistant Secretary Frederic W. Hickman, and attached is a copy of his reply.

**Questions 10 and 11**

In response to Question 10, we have prepared and submitted to the Office of Management and Budget a request for a supplemental appropriation for fiscal year 1975, accompanied by the request for fiscal year 1976. It is difficult for me to discuss these matters further in view of the restrictions placed upon disclosure of budget estimates and requests. I can tell you that we have submitted our request, and we are informed that we will know the outcome within a matter of days. We will be pleased to submit a detailed response to this question as soon as we can.

Question 11 presents the same restrictions on disclosure I pointed out above. The Internal Revenue Service, like all other executive agencies, was instructed by the President to prepare recession documents designed to reduce the fiscal year 1975 budget allotment by a certain amount. I understand those will be sent to Congress in due course. As soon as possible, we will be pleased to provide the Subcommittee with a detailed report of the nature of those budget reductions, including detail about specific programs and activities involved in cutbacks and the amount of reductions applying to such activity.

**Questions 12 and 13**

My letter of November 19 contained our response to Questions 12 and 13.

DEPARTMENT OF THE TREASURY,  
Washington, D.C., November 22, 1974.

HON. VANCE HARTKE,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: In your November 6, 1974, letter to Commissioner Alexander you list thirteen specific issues on which the Subcommittee on Foundations desires information in connection with hearings scheduled for November 25 and 26. Commissioner Alexander and I have discussed your letter and have agreed that I will supply the Treasury Department's comments on items 8 and 9 which concern the annual determination of the minimum pay-out percentage for private foundations. Specifically, your letter asks:

8. One of the recommendations contained in the attached report of the Senate Subcommittee on Foundations is that section 4942 be amended to give the public an opportunity to comment on proposed changes in the applicable percentage. What is your reaction to this recommendation?

9. A second recommendation suggests the means by which a reasonable standard for determining the applicable percentage under section 4942 may be determined. What is your reaction to this proposal?



1. *The minimum distribution requirement.* Section 4942 requires private foundations to make minimum annual charitable distributions equal to their actual income or a stated percentage ("applicable percentage") of their investment assets. Section 4942(e)(3) provides that for taxable years beginning in 1970 the applicable percentage is 6 percent. For subsequent taxable years the applicable percentage is to be determined and published by the Secretary of the Treasury, or his delegate, as necessary to reflect changes in "money rates and investment yields." More specifically, the applicable percentage for a taxable year is to bear the same relationship to 6 percent as money rates and investment yields for the calendar year immediately preceding the taxable year bear to money rates and investment yields for the calendar year 1969.

Under these provisions, the applicable percentage for new foundations (i.e., those formed after May 26, 1969) for the taxable years 1970 through 1974 has been as follows: 1970, 6 percent; 1971, 6 percent; 1972, 5½ percent; 1973, 5¼ percent; 1974, 6 percent.

Pursuant to the transitional provisions of the Tax Reform Act of 1969, lesser percentages have applied during this period to foundations formed before May 27, 1969.

2. *Standard for determining annual changes in applicable percentage.* The October 1 statement of the Subcommittee on Foundations notes the testimony of witnesses suggesting that the substantial increase in the applicable percentage for 1974 (from 5¼ percent to 6 percent) indicates that the Treasury Department, in determining the applicable percentage, has not taken into account changes in "investment yields" but only fluctuations in interest rates. The October 1 statement further states that changes in the applicable percentage "must take into account the equity side of foundation investment activity" and suggests that an appropriate approach might be to use a composite index, giving equal weight to the Dow Jones Industrials dividend yield, the Standard and Poor's 500 stocks dividend yield, interest rates on Barron's or Moody's highest rates bonds, and interest rates on long-term United States Treasury obligations. Question number 8, quoted above, requests our comments on this suggestion.

At the outset, we would stress the fundamental fact that dividend yields are not a full and fair reflection of the investment yield on equity securities. The increase in corporate value attributable to retention of earnings in the corporate solution must also be taken into account. Indeed, one of the primary abuses to which the minimum distribution requirements were directed was just this: that a private foundation investing in low dividend securities (e.g., stocks of many closely held companies and growth stocks) might make minimal charitable distributions and exist primarily as a vehicle for wealth accumulation. Accordingly, the 1969 Act set the minimum distribution requirement at a rate substantially above average dividend yields. Comparing the average of the Standard and Poor's dividend yield and the Dow Jones Industrials dividend yield for the years 1969-1973 (as shown in the attached table) with the private foundation applicable percentage for 1970-74, it can be seen that, on the average, the minimum pay-out requirement has exceeded average dividend yields by 2.3 percent.

The proposed composite index procedure for changing the applicable percentage would not, of course, make the applicable percentage directly dependent on dividend yields. Instead, changes in dividend yields would be averaged with changes in interest rates, and changes in the applicable percentage would not be keyed directly to the resulting average but to the ratio of that average for the current year to the average of the same dividend yield and interest rate indices in 1969. Nevertheless, inclusion of dividend yields in the composite index is subject to the same criticism that dividend yields are not an adequate measure of investment yields on equity securities. Moreover, due to reluctance of corporate management to reduce dividends in periods of low corporate earnings, dividend yields tend to fluctuate quite widely and to be an unstable indicator of investment earnings. This is reflected on the attached table in the very high dividend yield for 1974, a period of depressed securities prices.

Over the last five years the Treasury Department has considered a number of different methods of computing annual changes in the applicable percentage, including various composite indices. As a result of these studies we have concluded that the best measure of changes in investment yields and market interest rates is the change in yield on 5-year Treasury securities, and the applicable percentages

for 1973 and 1974 were determined on that basis. This reflects our understanding of the intention of Congress that changes in the private foundation minimum distribution requirement should reflect substantial and enduring movements in investment yields, rather than merely transitory market conditions. Unlike dividend yields and interest rates on long-term bonds, which tend to fluctuate in accordance with transitory market conditions, the yield on 5-year Treasury securities more nearly measures more prolonged and more fundamental changes in investment yields.

The attached table compares the results that would have obtained had the 5-year Treasury index or, alternatively, the suggested composite index been used throughout the period 1970-1974. As can readily be observed, the composite index approach would have resulted in a higher pay-out requirement for most years in the period.

3. *Provision for public comment on changes in the applicable percentage.* Assuming a consensus on the appropriate indices to be used as measures of changes in investment yields and money rates, the actual determination of the applicable percentage for a particular year is essentially a mechanical procedure. As such, public comment is not required under the Administrative Procedure Act. We also question whether public comment on particular changes would be helpful. Among other things, it is essential that the applicable percentage be published as soon as possible each year for the guidance of private foundations in their investment and charitable activities, and providing for public comment would very probably delay such publication. We welcome, of course, public discussion and comment on the basic question respecting the choice of indices to be used in computing changes in the applicable percentage. But that question needs to be resolved in terms of long-range considerations rather than its effect on any particular annual change in the applicable percentage.

In conclusion, I would like to add some comments directed more generally to the subject of the hearings, the impact of the state of the economy on private foundations. As the attached table indicates, the present provisions will require a substantial increase in the applicable percentage, whatever method of computation is used. Taking into account probable fourth quarter investment yields, the applicable percentage for 1975 may be as much as 7 percent, or more. For pre-1969 Act foundations, that would be an increase from 5½ percent for 1974. The prospect of such an increase, at a time when the asset value of many foundations is substantially depressed, is naturally a matter of serious concern to private foundations. Responding to such concerns, the Ways and Means Committee has tentatively approved a provision for a reduced (i.e., 4 percent) minimum distribution requirement during a further five-year transition period, where the application of the present requirement would reduce a foundation's asset value below its asset value on January 1, 1970.

Sincerely yours,

FREDERIC W. HICKMAN,  
*Assistant Secretary.*

TABLE 1.—DERIVATION OF REQUIRED PAY-OUT RATES FOR NEW PRIVATE FOUNDATIONS

Year	Percentage change in yield (1969=100)		Required pay-out rate, based on:	
	5-yr Treasuries	Composite bond and stock yields	5-yr Treasuries	Composite yield
	(1)	(2)	(3)	(4)
1969.....	100.00	100.00		
1970.....	107.98	112.44	6.00	6.00
1971.....	87.65	97.42	6.48	6.75
1972.....	87.56	92.00	5.26	5.85
1973.....	100.63	99.52	5.25	5.52
1974.....	114.53	129.25	6.04	5.97
1975.....			6.87	7.76

Sources: Col. (1): Table 2, col. (2). Col. (2): Table 2, col. (11).

TABLE 2.—SELECTED INDICATORS OF YIELDS ON BONDS AND COMMON STOCKS, 1969-74

Year	Other bond and common stock yield indicators										
	5-yr treasuries		Standard and Poor's, dividends		Dow-Jones 30 dividends		Moody's Aaa corporate bonds		Long-term Treasury bonds		Com- posite percent of 1969
	Yield	Per- cent of 1969	Yield	Per- cent of 1969	Yield	Per- cent of 1969	Yield	Per- cent of 1969	Yield	Per- cent of 1969	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	
1969	6.832	100.00	3.24	100.00	3.81	100.00	7.03	100.00	6.10	100.00	100.0
1970	7.377	107.98	3.83	118.21	4.17	109.45	8.04	114.37	6.59	108.03	112.44
1971	5.988	87.65	3.14	96.91	3.58	93.96	7.39	105.12	5.74	94.10	97.42
1972	5.982	87.56	2.84	87.65	3.29	86.35	7.21	102.56	5.63	92.30	92.00
1973	6.875	100.63	3.06	94.44	3.62	95.01	7.44	105.83	6.30	103.28	99.52
1974	7.825	114.53	4.19	129.32	6.00	157.48	8.42	119.77	6.98	114.43	129.25

<sup>1</sup> Average of 1st 9 mo.

<sup>2</sup> Estimated annual average.

Source—Col. (1): U.S. Treasury, Office of Debt Analysis; col. (3): "Economic Indicators"; col. (5): Unpublished series furnished by Dow-Jones, Inc.; col. (7): "Economic Indicators"; col. (9): "Economic Indicators"; col. (11): geometric mean of cols. (4), (6), (8), and (10).

Senator HARTKE. The next witness is Mr. Eliot Janeway, an economist. Good morning, sir. I know you are anxious to proceed.

#### STATEMENT OF ELIOT JANEWAY, ECONOMIST

Mr. JANEWAY. Mr. Chairman, I appear on my own behalf, and our family does have a small foundation, which we anticipate liquidating.

Senator HARTKE. Liquidating?

Mr. JANEWAY. Yes, sir.

Senator Hartke, your call for discussion of the problem confronting foundations, and of the resultant problem foundations are making for the Treasury and the institutions dependent on its established welfare programs, puts the policy question with realism we have come to expect of you. Your letter states, "There has been some concern expressed recently in the media about the erosion of foundation assets due to the poor performance of investments. It is possible that some foundations will have to curtail grants because of decreased income from investments. This is most disturbing at a time when the Federal Government may also be forced to cut back on some of its domestic programs." Senator, your formulation is an understatement.

As we know, the Federal Treasury can count upon two alternative sources of funds, and two only. Tax collections from participants in the economy during their earning lifetimes or at death are the first; borrowings are the second. As we also know, borrowings—whether by the government or by participants in the economy—are the specific carrier of the inflationary virus. Every participant in our economic society is well qualified at this stage of today's crisis of the inflation of costs and the resultant deflation of values to testify as an expert on the dire consequences of borrowings not supported by cash flows. As we have also been learning, if we did not know it, the specific measure of the rate of inflation resulting from the rate of overborrowing in anticipation of earnings not materializing is the rate of interest.

Your distinguished colleague, Senator Harry F. Byrd, Jr. of Virginia, is universally acknowledged to be the country's leading authority on its fiscal plight. His calculations show that the Federal dollar borrowings have come to account for well over 60 cents of every dollar borrowed in the United States today. The present crisis is approaching a climax in its breakaway lurch past the familiar but no longer alarming symptoms of recession to the no-longer-forgotten and no-longer-discounted danger of depression. Consequently, speculation is no longer productive on whether the governmental hare has run its spending too far ahead of the taxpaying tortoise, or vice versa.

What confronts us now is not a theory or a preference, but a condition. The Treasury needs all the help from alternative sources of funding for approved and accredited welfare programs that it can get and that participants in the economy can provide. This problem has been a recurrent one in our history. I suggest, however, that we have come a long way in America since the founding of the Republic when Hamilton proposed to cure the consequences of the fiscal irresponsibility of the Continental Congress by structuring a class of creditors on top of the Treasury as a balance against the claims of the beneficiaries of its operations. We have come an even longer way since the tremors suffered during the crisis of 1896, when President Cleveland found himself forced to treat with a syndicate of foreign promoters through their Wall Street agent, Mr. Morgan, as if he were the head of a government defeated on the battlefield offering unconditional surrender to a coalition of victorious invaders. And I am confident that we have passed the point of no return from the disaster accepted at the worst of the last depression, when the President of the United States disclaimed any responsibility for avoiding the event, or even for caring for the needs of its victims.

But we have not come so far that we can afford to disregard, much less to outlaw, an entire class of participants in our economy who are equipped to invest retained earnings according to explicitly prescribed and administered guidelines to supplement programs which the Federal Treasury is admittedly not in a position to fund without recourse to still further borrowing. Today's twin test for considering any governmental activity is, first, whether the Treasury would be obliged to increase borrowings to sustain it; and, second, whether alternative sources of finance not inconsistent or conflicting with public policy are available. I believe, Senator Hartke, that you and I share a vivid recollection of the late President Johnson in his then capacity as the unforgettable Senate majority leader; 1958 was a year which seemed troubled at the time. It seems tranquil alongside today's crisis. Johnson felt prompted to warn his colleagues to stop relying on Federal spending to serve as their sole support for humane and progressive programs, and to start looking to participants in the economy to respond to invitations to provide alternative private sources of finance in implementation of public policies appropriately supervised.

Such an alternative source of finance exists for ready mobilization as an instrument of public policy in the form of the private family foundation. I suggest the appropriateness of considering the applicability of Voltaire's famous dictum about God—that if He had not existed, we would have had to invent Him—to the availability of

the country's many family foundations to help fill the widening fiscal gap between the expanding needs of welfare programs and the limited capacities of government to fund them. Yet the family foundation as an institution is being subject to punitive treatment, as if it were diverting funds from the Treasury instead of providing the alternative source of finance so desperately needed by it and the claimants on its welfare programs. It is common knowledge that an overwhelming consensus of legal opinion is now advising clients who sponsor funds to start shrinking them with a view of liquidating them. I am confident that the records of the Internal Revenue Service show a decided shrinkage in the number of applications for foundation status. We are systematically engaged in demobilizing these alternative sources of support for our shrinking Treasury operations and our faltering welfare programs, just when rudimentary common-sense calls for mobilizing them.

Ironically, the sponsors of family foundations will not be hurt by responding to the regulatory pressure to liquidate. Gift deductions from income will still be available to taxpayers. But the capital flows needed by the Treasury and the country's welfare institutions will no longer be available.

The question you have formulated, Senator Hartke, cuts across the spectrum of Treasury operations, welfare programs and the condition of the investment markets, as well as the high rates being earned from them. Today's unprecedentedly high rates of interest are at once a judgment of and the measure of our fiscal failure. Remedies, are clearly needed to begin rolling these interest rates back, and keep them rolled back. The way to do so is by limiting further overborrowing. Meanwhile, the Federal Treasury is clearly the victim of the situation it has created. It is clearly not in a position to derive any benefit from present interest rates by operating as an intermediary using income from the investment markets and disbursing it to qualified welfare programs. But foundations can.

The greater the investment availability foundations can be counted upon to commit to the securities markets, the more effective they—and the Treasury—will be in balancing the seemingly endless demand on the credit market for income securities bearing long dated maturities with new supplies of hard cash. Ironically, this extra margin of availability was present and accounted for in our securities markets when it was not needed—as it is urgently needed now—in the bygone era of low interest rates when the Treasury's flexibility of maneuver was not yet exhausted and when the claims of welfare programs were still being funded with relative comfort. But now that this availability is needed, the investment markets are being deprived of it.

The spectacle of the Treasury in its present plight, putting family foundations out of business, conjures up visions of the Count of Monte Cristo running out of money and airing his delusions of grandeur as a welfare client himself. Early in this century, before today's welfare needs were recognized and before the Government was thought of as responsible for financing them, Mr. Justice Holmes wrote a classic opinion in which he commented that confiscating the entire fortune of the first Mr. Rockefeller to come into national prominence would be counterproductive, because, if redistributed, only dimes would be

added to everybody's income, and nonrecurrently at that. The same stern logic applies to the de facto death sentence to which family foundations are now on notice to regard themselves as subject. Even the extreme of instant preemption of all the resources of foundations would not help the Treasury or the country's health, educational, and community service institutions close their deficit gaps. But it would bring large-scale damages to the securities markets and the institutions dependent on income from them, and at a time recalling the admonition to avoid shooting the wounded.

Turning to the side of the question raised by your reference to the sad state of the investment market, the shrinkage of participation in them on the part of investors in quest of continuous income is increasingly recognized to be the root cause of the operational difficulty afflicting the market. It is one of the paradoxes of inflation that record levels of investment return have coincided with sharp shrinkages in the participation of income-minded investors.

My studies of the performance of the investment markets in recent years have led me to the firm conclusion that the reliable and consistent leading indicator of price deterioration in the securities markets has been the shrinkage of trading volume. This erosion has in turn reflected the withdrawal from the securities markets of income-minded investors of average size with no conspicuous commitment to spectacular performance in any single period, but rather committed to earning reliable rates of return needed to support systematic rates of committed outflow. The diminishing participation of foundations, resulting from their forced shrinkage, has contributed to the dismal market trend noted in your letter. Moreover, it has invited the markets to anticipate their elimination altogether in a matter of years. Persistence in present policy will compound the damage. Reversal of it will relieve the suffering that began on Wall Street, but is no longer limited to it.

May I suggest a simple remedy calculated to start helping the Treasury to stop hurting the castoff wards of its welfare bounty by granting a conditional reprieve to family foundations. I will not presume to suggest percentage limits by any standard which your subcommittee may deem appropriate to recommend to the Congress. I do, however, suggest that the approach I am recommending be adopted until such time as the securities markets roll back long-term interest rates on high-rated bonds to 6 percent, and until total Federal borrowings account for closer to one-third of all borrowings in this country, instead of the present two-thirds.

I am anxious to emphasize that I do not regard these two standards as an either/or proposition. On the contrary, I have every confidence that a return to 6 percent rate of return on quality bonds, plus a willingness to hold them, will coincide with a rollback of borrowings to a mere one-third of total U.S. borrowings.

My recommendation is calculated to offer family foundations an opportunity to furnish a lead in this direction. It reckons on the companion axiom to the basic one that governments can raise money either by collecting it from taxpayers or borrowing it from lenders. The taxpayers' side of this calculation is that participants in the economy are offered the choice, whether they know it or not, of paying taxes directly in levies to the Treasury, or paying them indirectly through the toll taken by inflation.

Foundations, to the extent they are tolerated, subsist in a misty no man's land because they are disqualified from retrieving cash drained by taxes paid with new earnings from recurrent operations. Consequently, taxing them condemns them to death by attrition—especially in the investment climate described so realistically, Senator Hartke, in your letter; the tax code accords taxpaying earners the right to recoup their losses before accruing taxes, but this privilege is wasted on foundations whose gains go to their beneficiaries and whose losses are their own.

The simple alternative is to offer foundations a tradeoff with inflation as an alternative to taxation. Coping with inflation is the name of the game in the securities markets. Why not supplement the operational ban on what foundations can do with their money by conditioning their continued existence on their willingness to invest some reasonable portion of their existing portfolios, plus another reasonable proportion of new inputs from their sponsors, into non-negotiable Treasury securities redeemable at par in—say—5 years? Why not explore this road to relief further by denominating these non-negotiable securities, to the extent they are bought subject to maturities longer than 5 years, as drafts which qualified welfare institutions, such as colleges or hospitals, could present to the Treasury as cash claims 1 year at a time?

This device would put the Treasury in the position of collecting more than 5 years' worth of dollars in advance for every such dollar paid out, and it would give the beneficiary institutions the double benefit of receiving the income as well as 1 year's face amount each year for a period of years. Borrowing long term to spend 1 year at a time would signal a welcome reversal of Treasury operations. And, finally, why not offer a direct contribution to solving the original problem of social stability recognized by Hamilton in his call for the funding of the debt, but without accepting the alien expedient Hamilton had in mind of endowing a privileged class to do it. The procedure I am recommending would merely treat donations given to foundations and income earned by them as alternative conduits to claimants for funding by public welfare programs. Foundations committed to the continuous investment of cash in Treasury securities maturing five years or longer would make a constructive contribution against inflation. By contrast, continuous buildups in Treasury pressure on the short-term money markets, for lack of any willing or able institutional buyers to absorb longer-dated securities from it, will continue to fuel the engines of inflation.

May I take this opportunity to note that the legislative and executive branches of the Government have just invited the shrinking number of owners of excess liquidity to go in exactly the opposite direction. I refer to the act legalizing the private ownership of gold, which would have the effect of shrinking the available stock of cash in income-bearing securities. Worse still, it will withdraw from the country's banking system the already limited availability for the purchase of negotiable short-term Government securities. The only logic I can find for our Government to have sanctioned this run on the banking system—and the Gold Legalization Act will cause a run—and the investment markets at this stage of financial crisis is that of consistency. It is of a piece with the strategy which has brought us to our present

pass. I would like to associate myself with the call of Dr. Henry Kaufman, the distinguished economist of Salomon Bros., in asking for a delay in the effective date of this act in the hope that the Treasury will use the time to bring its affairs into some semblance of good order.

A final consideration is on my mind. It is one of equity. The Congress has been called upon to undertake a probe of the public policy implications of gifts by one figure in the public eye on a scale greater than representative participants in the economy are accustomed to make—even to qualified welfare beneficiaries. The unanimous vote of the Senate Rules Committee in qualifying the appropriateness of the large-scale gifts under scrutiny to mere individuals suggests the equity of discontinuing the disqualification of the more modest gifts family foundations are accustomed and positioned to give to qualified welfare institutions.

Thank you.

Senator HARTKE. I hope your warning about the dissolution of family foundations is not true. That is one of the reasons we are in this hearing, to find out what is going on, to make sure we can correct any inequities that do exist.

Mr. JANEWAY. I think, Mr. Chairman, you will find that a large scale systematic shrinking under advice to liquidate is the case, with very little publicity.

Senator HARTKE. We have been trying to get that information from the Internal Revenue Service, and it is just not available to us, and I think if you listened this morning, you found out we are not in a position where we have any reasonable expectation to get very much, very soon.

Mr. JANEWAY. My statement, Mr. Chairman, suggests another question or another line of questioning to put to the IRS, namely the number of new entries and new closeouts of family foundations.

Senator HARTKE. We are trying to get that. They do not have that.

Let me say the other idea about the Treasury, the investment in the Treasury system at least is a novel one. We will pursue it, and it reflects your usual ability to look into the future.

I want to congratulate you for your testimony today.

Mr. JANEWAY. Thank you.

Senator HARTKE. All right, fine.

Now, we have a situation in which I think some people are trying to catch some planes. One of them is, I think, Dr. John H. Knowles. Is that correct, John, are you trying to catch a plane, too?

How about Roger Kennedy and Harold Howe, is that true, too?

Mr. HOWE. Yes, sir.

Mr. KENNEDY. Yes, sir.

Senator HARTKE. All right, Dr. Knowles, if you will proceed.

#### **STATEMENT OF DR. JOHN H. KNOWLES, PRESIDENT, THE ROCKEFELLER FOUNDATION**

Dr. KNOWLES. Thank you very much, Senator Hartke. I appreciate your hustling me through. The annual meeting of our board of trustees takes place on Sunday, so our staff is working hard at the moment.

Senator HARTKE. That is good. We got you at a good time.



Dr. KNOWLES. Hopefully, I did spell out to your satisfaction responses to some of the questions that you asked and the reasons for your holding this hearing, and I will just summarize them very rapidly.

The Rockefeller Foundation was founded in 1913. I think that was the same year that the amendment to our Constitution provided for the levying of an income tax by the Federal Government, and also the amendment to the Constitution which provided for the direct election of Senators.

At that time in 1913, and subsequently over the next several years, the original John D. Rockefeller left a total of \$258 million. Over the past 60 years, to 1973, the foundation paid out \$1.2 billion for philanthropic purposes, one quarter of a billion dollars in excess of its income over the 60-year period.

Although there have been similar periods of stagnation in the economy, the recent period has been particularly severe, because of the serious decline in the value of our assets, and even more important, because of the impact of inflation, both internally on our own operations and externally as it affects our grantees. Internally, inflation increases our administrative costs, the costs of all of our staff and program officers. In turn, this reduces the amount of money that we are able to devote to either the grant making process or to our direct field operations. Bear in mind that we are one of only a handful of foundations which both make grants to other organizations and also have direct operations in the field conducted by our own staffs, particularly in the less developed countries.

The external effect of inflation on those who look to us for grants has been devastating, largely because most of our grantees are in the labor-intensive services such as education, health, the performing arts and so on, where they have relatively fixed productivity and most of their costs are in the costs of their people. In the case of hospitals or health institutions, for example, three quarters of their costs are in the direct salaries of their employees—professors or nurses or technicians or what have you—so that their capacity to keep up, particularly during times of inflation and reduction of governmental expenditures is seriously threatened.

In the 60 years of our foundation's life we have regularly paid out more than our income—practically speaking in every year since we were founded. The table attached to my statement shows the actual facts for the last decade, Senator. In 1968, before the Tax Reform Act required any fixed payout, the trustees of the Rockefeller Foundation elected to try to moderate the effects of a cyclical economy by adopting the policy of appropriating  $5\frac{3}{4}$  percent of an average annual market value of our assets over the preceding 4 years, and this has given some stability. For example, this year, 1974, we will have appropriated roughly \$49 million. Our guideline for next year, taking  $5\frac{3}{4}$  percent of that 4-year-moving average, will be about \$45 million.

Bear in mind, these are merely meant to be guidelines. Next year we expect to spend somewhere around \$45 million, which is essentially the same as we have spent in both 1973 and 1972. However, if some unusual opportunity were afforded us, nationally or internationally, we

might spend well beyond that general guideline. In other words, \$45 million is only a self-imposed guideline. If somebody had a wonderful idea that required \$5 million and there was nobody else to support it, and our trustees agreed, we could spend \$50 million in the coming year.

I would also like to explain that when our trustees approve large grants, for example to a university in this country or to an agricultural school, they are frequently paid over a period of 3 years or more. For example, they may appropriate \$600,000 for a 3-year grant, to be allocated at the rate of \$200,000 each year. So long as the conditions of the grant are met, the institution can count on receiving these payments each year. Even if the stock market fell to a Dow Jones of 300, we would still use our remaining assets to make those payments over the 3 years. Each year starts a new budget cycle. A substantial part of the \$45 million to be appropriated next year may be allocated and paid out over 1, 2, 3, or 4 years. At the beginning of the following year we then start a new cycle.

In other words, if we fall upon bad times we do not say to the university 2 years from now, we are sorry, our assets went way down so we cannot give you the \$200,000 this year. We will give you maybe \$50,000. In other words, once a grant is made, payment is virtually assured to our recipients, short of the entire bottom dropping out of the market. If that happens, the entire country will have a larger set of problems before it.

I would like to make one other point. Even without the devastating effect of inflation on largely service institutions, such as universities, hospitals and so on, one element that people have neglected is the fact that today the complexities of a given social problem demand larger numbers of people—scientists, technicians, economists and so on—for their study and solution.

No matter what the problems in education, health or any other field, transportation, daycare, welfare reform, the plight of minority groups, you name it, larger numbers of problem solvers are required. In contrast to perhaps 20 or 30 years ago, when one individual might be able to encompass a given problem, today the problems are of such complexity that they require large teams of professionals from different disciplines to resolve in a rational fashion the issues that face us. As a result the absolute cost of supporting the advancement of knowledge and its utilization is much more today than it was 20 or 30 years ago.

Twenty or 30 years ago support for research on development of the yellow fever vaccine might have involved a small group of people. Today we have to support that same number, plus a goodly number of economists, political scientists, and cultural anthropologists to help determine how we can use that information here and around the world, recognizing that social, economic and cultural determinants to the use of knowledge are today much more heavily involved in the successful amelioration of human misery.

With respect to the existing law, as stated in the prepared remarks, the Rockefeller Foundation urges the reduction of the excise tax on private foundations from 4 to 2 percent. In our own case, in the last 4 years we would have been able to allocate an additional \$3.5 million

for charitable purposes if the excise tax had been reduced to that level. For foundations at large, I think that last year alone it would have freed up some \$40 million for charitable grants and direct operations.

We also recommend that the mandatory payout requirements be fixed in relation to the long term rate of real returns on investments.

I have had the opportunity to see the statement of Roger Kennedy, vice president for financial affairs of the Ford Foundation, and of Dr. Robert Goheen, the chairman of the Council on Foundations, and I am fully in accord with their conclusions which are based on their knowledge and expertise in this field.

Last, this year, at the conclusion of my first 2 years with the Rockefeller Foundation, we completed a very intensive review of all of our activities. I have a copy of the trustees' report based on that review, "The Course Ahead", which I respectfully request be entered in the record of your hearing, if that is all right.

Senator HARTKE. Yes; that is all right.

Dr. KNOWLES. This report amplifies some of the remarks in my written statement.

Thank you.

[The information referred to appears on p. 61.]

Senator HARTKE. Is it your judgment there will be a substantial cutback in the amount of grants to be made by foundations this year?

Dr. KNOWLES. From what I read about the major foundations, I would have to say yes. It is both in terms of the absolute amount of money that is going to be available to be spent this coming year and the eroding effects of inflation on the recipients of these grants. They do not need less money today, they need more, and that, combined with a reduction in the absolute amounts that many foundations can give because of the erosion of their assets will I believe, result in a substantial cutback.

Senator HARTKE. In other words, even if the same amount were granted, the effectiveness of it in real terms, in dollars, is not the same.

Dr. KNOWLES. Very definitely, Senator, yes.

Senator HARTKE. Will this in any way affect the grants which are made for innovative purposes?

Dr. KNOWLES. Yes, I think it could. That is a very interesting question.

Senator HARTKE. In other words, you go back to the more traditional grants, is that what you are saying?

Dr. KNOWLES. Yes, indeed, I think it could because foundations should not be so far out in front that they are supporting innovative ideas and creating new institutions when the existing islands of excellence in this country are suffering from inflation and a cutback in the available sources of support.

So I think it could hamper the avowed purposes of the major foundations.

Senator HARTKE. Do you have a dollar amount on about how—forgetting the other side of the coin for a moment—the effective rate vis-a-vis the change in the value of the dollar and the needs, but just in actual grants themselves, do you have any estimate as to the amount that you think the cutback will be in the coming year?

Dr. KNOWLES. I do not, Senator. I am sorry, I do not. I think from the standpoint of the Rockefeller Foundation I would say overall I would have to use an arbitrary figure that we would be at least \$4 million less effective this year than we were last year, if you are judging us just on our ability to make grants, \$1 million of that by our guidelines, but over \$3 million due to the effects of inflation.

For example, in our international programs, we run a conference center in Bellagio, Italy, and the 20-percent inflation rate in Italy means that our budget for that operation alone, which is about a half a million dollars a year, will be increased by 20 percent because our costs there—of course most of our employees there are Italians—are affected by the even higher rate of inflation in Italy.

Senator HARTKE. What I was driving at, do you think if you had the reduction of the tax from 4 percent to 2 percent, would that effectively offset the decrease in the ultimate amount of grants that are anticipated this year?

Dr. KNOWLES. In our case, it would help if the 4-percent surtax were done away with completely. It would give us about another \$1,300,000.

Senator HARTKE. Generally speaking, I gather that you are not very happy with the distribution requirements of the 1969 act, and you feel that maybe the reason they were put into effect at that time, that those reasons no longer apply, or maybe are no longer applicable or never were, but what do you substitute in its place?

Do you feel any type of distribution requirement is necessary?

Dr. KNOWLES. Yes. I do. I think a rational distribution requirement, which is based on the long-term rate of real returns on investments would accomplish what I understand was the original purpose for the payout requirement, and pay heed to the original reason for granting tax exemption, which was to stimulate giving to needy and worthy causes and to foster voluntarism.

So you still should have some payout requirement, but I think it could be related to existing economic conditions and rise and fall with them so that the inevitable would not happen. Once you get the payout requirement up to a certain level, not only are you discouraging people from establishing new foundations, but you also are going to erode the real potential of the major foundations and over a period of time they could be put out of business. This gets us into a larger issue. Those of us at least who work in foundations believe that foundations and what they stand for in terms of the institutionalism of pluralism, heterodoxy, and the necessity to have both a strong public as well as private sector in the United States, are absolutely central to our past and future successes.

Senator HARTKE. Do you not think that a requirement by the Congress setting forth the general standards of distribution would be helpful?

Dr. KNOWLES. Yes; I think it would be helpful.

And I think again—

Senator HARTKE. You see, I think the one problem that most people fail to see in our study of foundations is they want to deal with the minutiae, well, of the excise tax, or the distribution problem, but ultimately you come back to something which may be very subjective, and I have asked this question a number of times, just what are foundations trying to do?

Dr. KNOWLES. Well, that is what I had hoped you would ask, Senator, because I agree with you. I think that that ultimate question has to be answered satisfactorily, and then the means to these ends can be quite easily dealt with.

Senator HARTKE. Do you think we have such an understanding or such a philosophical approach at this moment?

Dr. KNOWLES. I quite frankly do not think we have answered the question satisfactorily in the modern world. I think we can look at—

Senator HARTKE. I am sure glad you answered it that way. I thought maybe I was the one who did not understand.

Dr. KNOWLES. No; I have been struggling to answer that myself. My belief and the basis of my knowledge so far are derived from 20 years of raising money from foundations as a director of a voluntary hospital associated with a university to suddenly, 2 years ago, finding myself on the other end of the pipeline. Clearly I would not have come to New York City to be the head of the Rockefeller Foundation unless I believed that it could be shown that foundations are absolutely central to what we believe in this country.

I do not know how much time we have. I would be happy to try to give you the answers that I have found so far. Inevitably it would involve me in specific anecdotes testifying to the past successes of the Rockefeller Foundation, but I think we are less-interested at this juncture in past successes than we are in specifically what foundations are going to do with their real power and influence, in the best sense of those terms, for the future.

In terms of the past history, during the first 30 years the Rockefeller Foundation dealt largely in matters of public health, culminating in the development of the yellow fever vaccine by one of our staff members, Max Teiler, who later received the Nobel Prize for this achievement, its work in the eradication of malaria around the world, and in hookworm in the South. It also made contributions in establishing departments of psychiatry in the major medical centers of this country, in helping to implement the Flexner Report on Medical Education, in bringing modern physics to this country in the 1930's, in supporting the Social Science Research Council and the American Council of Learned Societies, and their work trying to improve the social sciences and humanities nationally. I could make you a long list of things that I think the foundation did at that time which quite frankly other private and public sources either had not recognized or were not willing to do.

The last 30 years, the Rockefeller Foundation got into the field of scientific and technical work in agriculture in developing countries. We had the flexibility and we were encouraged by our own Government to enter this field at that time. My predecessor, George Herrar, went to Mexico in the early 1940's, recruited Norman Borlaug and Edwin Wellhausen, working on wheat and corn respectively, and this, in retrospect, is recognized as the origins of the so-called Green Revolution.

Certainly it has not solved every problem; certainly it has uncovered new ones. Norman Borlaug, a member of the Rockefeller Foundation field staff since 1940, received a Nobel Peace Prize for developing the new, bushy-headed forms of short, stiff-stalked wheat which revo-

lutionized world agriculture. As the world's population doubled over the last 25 or 30 years, the productivity of food production around the world also doubled. There is sufficient knowledge today to do it again before we reach the apocalypse which was predicted by the World Food Conference.

So I would have to say, on the basis of that work alone, that the Rockefeller Foundation again had justified its existence over the last 30 years.

But what does all this mean? It means that a foundation should have the flexibility, the knowledge, the staff, the trustees, their fingers on enough advanced thinking and information here and abroad to be able to identify leading issues and sustain effort on them over time, since very few governments can do this as the electorate periodically works its will. Foundations can sustain effort in scientific and technical and human concerns over time with assets and staff relatively unencumbered by political considerations; hopefully not too heavily influenced by the ebb and flow of the economy, they can, over time provide answers to the resolution of major problems that beset this country and the world.

When I arrived at the Rockefeller Foundation in 1972, we initiated a complete review of our activities. It took us 2 years to accomplish this with our 21-man board of trustees, and we came to the conclusions which are described in the attached, "The Course Ahead." Let me tell you something about our seven programs. We decided that we should continue our efforts in the program called "Conquest of Hunger," which involves extensive agricultural interests in this country and abroad. A second program entitled, "Population and Health," recognizes the inextricable links between the problems of populations and health. And you say, what genius does that take? Well, it does not take too much but the National Institutes of Health and the USAID have been the sources of money to advance knowledge in the field of population controls, ranging from basic research in reproductive biology to social, economic, and cultural and ideological determinants of population growth, and the present amounts of research that are going into the advancement of basic knowledge in this country and abroad are minuscule contrasted with the size of the problem.

Today the Ford Foundation and the Rockefeller Foundation provide most of the money for the basic research in population. This has nothing to do with ideology. It has to do with the advancement of knowledge. When we hear all of the rhetoric about whether economic development in the developing countries will ultimately limit family size, or whether it is just a matter of the technological fixes, or whether infant mortality has to fall before family size is limited, the fact is, there is not sufficient knowledge to know where the truth lies. Fundamental research that we support today is trying to answer these questions so that countries can set rational priorities. Where there is a lack of knowledge, mischief abounds and paralysis of action occurs, so that we think we have a unique role to play in this area.

A third program is called "Equal Opportunity." Its attention is directed specifically to minority groups. It stresses education and training, and the strengthening of institutions so that minority groups can bring about progress and reform through their own people.

The problems of racism are far from over in this country, and some people think we have entered a new era of reconstruction. Certainly there is a lot of public and private money in this area, but the Rockefeller Foundation has a long history of contributions here. It has supported black colleges in the South, and, more recently, has stressed the training of school administrators from innercity areas around the country who then go back with an expanded capacity to manage their own systems.

Quite apart from our scientific, technical and educational interests, after an extensive review, we have increased our efforts in the arts and humanities. We keep talking about no growth or limited growth in this country, while the rest of the world is criticizing our endless materialistic desires and overconsumptive habits. Simultaneously we see the workweek shortening and people are going to begin wondering what they are going to do with their spare time and we increasingly hear the question, what does the quality of life mean? There is barely sufficient support for the arts in this country today; even though we have a national endowment spending about \$70 million per year and State councils spending as much as \$40 or \$50 million. There is still plenty of room for the handful of foundations which are trying to give ongoing support to the performing as well as the visual arts. In addition, the humanities give meaning and understanding to the human condition and lend insight into the complexities of contemporary problems.

So we think we have a very important role to play at the forefront of trying to generate more public support for the arts.

When it comes to the humanities in this country, however, you want to define the humanities, whether you want to include historians, literary critics, people interested in foreign languages and so forth, support of the humanities in our country in the major universities has sunk to an all-time low. Once again this is a place for foundations to rivet attention. You have got to bear in mind that nobody listens to me personally, but anytime I talk or people come to see me about their programs, they see this large sum of money and potential influence behind me, and if we want to beef up a program in the humanities, many people will pay attention to that. It rivets public and private concern, and our job is to try to get more public understanding and public and private funds, for the support of the humanities. Once that is done we should move out of that and into other things.

Recently we have had series of grants which have supported a new group of economists, in the attempt to develop experts in international monetary affairs. There are only a handful of economists in this country today who understand the new complexity of changing world markets and international flows of money.

So we have developed a small series of fellowships for people to try to train a critical mass of these people who will over time bring their knowledge to bear on the problems besetting us.

On top of that, we are supporting economic research on the complexities of today's service industry, I could give you the names of the five economists in this country who fully understand the field of health, for example. There are only several people who understand the complexities of penal reform, the costs versus the benefits of

various programs of penal reform which would reduce the rates of recidivism and really benefit the community. Even the subject of day care, whether you are a conservative or a liberal makes no difference; the fact of the matter is that neither conservative nor liberal understands the real costs versus the real benefits of day care programs in this country.

We need much more objective knowledge about these things as we go from an industrial into a service economy, which is particularly vulnerable to inflation and whose advances are almost entirely predicated on the worth of their technical and professional institutions: The universities and hospitals, the research institutes, and so on. Their budgets are related directly to the excellence of the staffs they have.

Now, I do not think I have answered your question fully. Ideologically and philosophically I do believe that unless this country understands what pluralism means and the need for pluralistic approaches to problem solving, and unless it understands that no one of us, regardless of our ideology and regardless of our power position, no one of us, monolithic government or monolithic foundations or monolithic businesses can give us the answers to the question of the best route to the Promised Land. We believe in this country in the pull and tug of vested interests in the best sense of the word, in strengthening both the public and private sectors. We believe that none of us, as individuals, has the ultimate answers, and that our foundations are here to institutionalize our belief in pluralism and pluralistic approaches. We are in existence to support new ideas, to sustain excellence in institutions, and to complement Government programs which wax and wane depending upon the level of the economy and the changing whims of the electorate.

And finally, we do value heterodoxy. We are much too diverse a country to think that any one group can know what is best for Alaska versus California versus Massachusetts versus Mississippi. I think we have got to understand the virtues of pluralism and the real strengths of heterodoxy, and we must forever be able to tolerate iconoclasts.

I read an article in the New York Times on Sunday. It was Albert Shanker's column, which is paid for by his union of teachers, and I got three-quarters of the way through it. He was raising hell with the Buckley amendment, which provides that all families can look into the confidential records of their children in schools, and when they get to be 18, they can also look into their college record, including the letters that you or I may have written on their behalf, or perhaps not so much on their behalf. The student can look into his psychiatric records; he can find out what his family is making and all kinds of things. In fact the reasons behind the Buckley amendment are quite honorable in these sophisticated times, although the implementation of the amendment might require that we expand our law schools by about twice their present capacity. Indeed, in the extreme, the Buckley amendment could significantly alter the fabric of American society.

The implications of this are absolutely horrendous. If thought out, however, it is in keeping with the sophisticated approaches that this country is now using to assure fairness and equality to all individuals. So I am for it in principle, but not in its present form.



Now, I got all the way through Shanker's article, and I thought, I am glad to see that Shanker agrees with me. I am an overseer at Harvard, and we spent the last week talking about nothing but the fallout of the Buckley amendment. There down at the bottom, all of a sudden, bang, he goes after the Ford Foundation, and it turns out that the Ford Foundation made a grant to an advocacy group which is very interested in the rights of children and adults in schools to make sure they are treated fairly.

Well, all of a sudden, Shanker goes after the Ford Foundation for making a grant to this organization which was one of the organizations apparently that influenced Senator Buckley and the Buckley amendment. So let me explain how I get to my points.

The first point is that the Buckley amendment, it is good for the country, as long as it is finally rationalized, and I am sure, knowing the way our country operates, it will be rationalized.

Number two: What is the matter with the fact that the Ford Foundation supported a group which was interested in fairness to children and adults as relates to assistance to schools? Nothing. I think it is a great plus that we have this kind of ruckus going on. The day we cannot tolerate foundations or individuals raising hell in this country for good purposes and trying to cause change and making us all think harder is a day I think we go down the drain. I think in the late 1960's, we began to lose our sense of humor, either as doctrinaire liberals or doctrinaire conservatives. The times are very complex.

I think that foundations, if they are doing their job, are absolutely essential in terms of their flexibility, their willingness to take chances, their support of individuals and institutions who are supposed to be at the advanced stage of thinking about these problems.

Now practically speaking, before we made any one of our grants last year, we tried to help the recipient organization find comparable sums from other foundations, private sources in their cities and towns, or the Government itself. In some instances, we were successful. In many instances, there was no other source of support at the time to advance this kind of knowledge.

Now why should we be making grants to the Brookings Institution, or to the Bureau for Economic Research, which in both instances specifically support economists looking at these sophisticated services, and the costs and benefits of making certain changes in this country. Well, the money simply was not available any place else, and there is nothing doctrinaire about the approach of the Rockefeller Foundation to this. We are not interested in doctrines and ideologies. We are only interested in the acquisition of needed knowledge, its transmission, and its utilization. We have a long way to go in this new world, profoundly interdependent, profoundly confused about what is happening in this country and to the world, foundations have the flexibility needed to respond with grants to support the best individuals, to develop a new critical mass, for example, of international monetary experts. Apart from Paul Volcker, Robert Roosa and a handful of other people in the field of international monetary affairs, there are few who can figure out what is going on in this field today. Just the oil embargo and the trebling of oil prices by the Arab countries have had

more effect on unemployment in this country, and on marginal and minority workers than any other single event in the last 12 months.

Now we are in the midst of a very serious depression and a stagnant economy.

Part of this has certainly been generated by events far distant from our shores. Inflation in food prices was influenced heavily by the Russian drought in 1972. All these new phenomena and problems of interdependence make it extremely difficult for any of us as Americans to understand our own country's internal problems, much less those engendered by our interdependence with others.

This gives foundations a magnificent opportunity to encourage understanding of our new-found interdependence, and some of the new ways of looking at it, in everything from secondary education to college education to the rewriting of textbooks—and other areas which increase understanding.

Now this is a long and rambling answer to your question. I think that the foundations are going to have an even more difficult time in this coming decade, Senator, to prove their worth, but I think each and every one of them has an absolutely magnificent opportunity to do it. We have no excuse for not being able to prove to you that the privilege of sitting on relatively unencumbered money with very few political or ideological constraints on it is a privilege that very few people or institutions in this world enjoy. I can assure you that those of us who work in foundations are humbled by it, take it seriously, and work 7 days a week, 18 hours a day to try to justify our existence and carry out our mandate.

I used to get mad at all of these people at foundations. I used to crawl down to New York every year to see the big ones, to try to raise the money for the Massachusetts General Hospital, and to say that my feelings were ambivalent about these people is the understatement of all time. So I understand why there is a lot of ambivalence about foundations.

We have 7,000 wonderful people and institutions coming to us every year, and we can only support about 500 of them; this causes the other 6,500 to believe that we are fools, that we are arrogant, that we do not really understand what is going on because we did not support them.

We do not have a massive constituency that marches on Washington, and we did not in 1969. We very frequently make many more enemies than we make friends because we are in the business of making change, supporting iconoclasts and mavericks and so on, in addition to trying to provide ongoing support for the excellence of institutions in this country, whether it is Ohio State, the University of Indiana, the Lincoln Center in New York, Harvard, the University of Texas, or what have you. In these times of dismal economic conditions, lo and behold, as the Government cuts back, we have twice the number of phone calls, twice the number of applicants that we had last year or the year before, coming to us in complete frustration, asking why we, at least, can not help them.

So do not think for a minute that those of us who work in foundations are having a picnic right now. We have hundreds of phone calls, hundreds of people insisting on seeing us every day. I still say it is a wonderful privilege to be able to work in such an environment, and to

have this potentially real power and influence for the good. I still say that the times have changed rapidly, and I am not looking at the past. I think the past does justify where we are today, but I cannot count on that forever because you are going to have to ask us shortly, well what have we done that is new to resolve these major issues? How do we set up our priorities? How do we spend our money? How do we justify our existence in your eyes and in the eyes of the taxpayers of this country?

I believe firmly that we can do it.

Senator HARTKE. Well, I appreciate your exposition. I think you set forth some of the problems that are facing us. I think there is a general belief in this country in the doctrine of pluralism.

There are a couple of things that bother me. One of them is, when you deal with the Rockefeller Foundation, the Ford Foundation, you are dealing with a group of people who at the least can draw upon qualified individuals to make what they consider to be qualified judgments. What about smaller foundations?

Dr. KNOWLES. Some of the smaller foundations, depending on their mandates and the regions in which they work, have a professional staff; others do not. I know that the Council on Foundations and Dr. Goheen have felt very strongly about making professional staff advice available where requested by the more than 20,000 foundations in this country. Many of the small foundations of course, do not need staff. They will support their hospitals and churches and schools in the region and do a very good job of that and are a very necessary source of support.

I think more and more, however, that larger foundations are going to have to have either professional staffs themselves or have advice available from the professional staffs of the leading foundations.

When I first got to the Rockefeller Foundation, I made trips not only to some of the foundations that I knew in the Northeastern and Southeastern parts of the country to offer our help if needed, but also to let the people in North Carolina, for example know that when we made grants in North Carolina for the support of the performing arts that we wanted to work closely with the local foundations and people there to make sure that they understood why we were doing it. We were coming into their territory and we might join forces with them in the support of the performing arts in North Carolina.

The same was true of health and population programs that we have carried out through Duke and the University of North Carolina in that State. All of us are much more aware of this issue and are trying to work more closely with regional foundations and to offer our help where it is requested. The foundations themselves, I think, through Dr. Goheen and the Council on Foundations, are working on this issue.

Senator HARTKE. So this question of size does come into the question of when we establish whatever standards are going to be established in the field, not alone of distribution. But you see, I think someplace we are going to have to come back with some type of standard of not only distribution, but the standard of utilization, and I know that most people once I say that, it sends a little quiver through them because of the simple fact that it means that you have to have a difference of opinion.

Now I have not been known to be the most reactionary individual in the U.S. Senate, and I have taken on positions frequently which have not been very successful in their ultimate political effect.

But having said that, you know, I still come from the heartland, and I do not know how often you have been out in Indiana—

Dr. KNOWLES. I went to medical school in Missouri and was born in Illinois.

Senator HARTKE [continuing]. You see, we have a peculiar philosophy out there in one sense, and that is that we think the "eastern establishment" somehow or other has its head in the clouds, but forgot to put its feet on the ground. Now I am not one who necessarily subscribes to that. On the other side of the coin, let me say to you that the question of geography certainly is one that is being ignored by foundations, more so, in my judgment, than any other part of the field which either deals directly or indirectly with Government.

In the educational system, it has been able to adjust itself pretty much to the local conditions and the local environment.

And then I come back to another situation which bothers me. As I listen to you and I listen to your words, and the transcript will reveal it, I want you just to look at how many times you said "program," because I think we have a country which is program-oriented at the moment, or let me use a similar phrase—problem-solving.

Now problem-solving, I think, generally speaking, to most Americans means not really identification of facts, or related consequences as you have indicated; for example, as to what is a causation of high unemployment, high inflation, which may have a causal factor which cannot be directly traced to the question of how much you pay in wages or how much you pay in interest rates, because both of those basically are way down the line in the ultimate causation chain.

But is there a philosophy in foundations other than saying that we just want to do good? I mean is there a philosophy which can be translated into some type of overall, generalized standard? Let me say to you that I think that that is going to be a question which perhaps some in my generation are not going to ask, but I guarantee you my seven children are asking that question in so many fields today. We are a rather remarkable society in two fields, and that is, we are the first generation of man that has the absolute capability to physically destroy ourselves, as well as psychologically, mentally, and economically.

But we also have the opportunity in that same development of nuclear capacity to break into something different as far as opportunities for people, and secondarily, we are into that area of mankind in which, as you have indicated before, time can be devoted to the quality of life rather than just the sheer quantity of life. The tragedy as I look upon it is—and I think you adequately and definitely have pinpointed what I think is a real tragedy—is that while we are in a period where the education of humanity should be accelerated we are going in exactly the opposite direction.

In other words, here we have a chance to make life more beautiful, and we are destroying any effort to make life more beautiful. That is something, I think, we are going to have to address ourselves to.

Let me put it in a little different fashion. Whereas these hearings probably are to some merely a continuation of the invasion of Gov-

ernment in an area in which some feel we have no business being into or some would prefer we not get into, there is the mood of most of the people I see under the age of 30 which is questioning our institutions, and contrary to what most people say about that, I like it. I think we are into a philosophical age of doubt in which no longer can you simply go ahead and say, we had 30 years of the Rockefeller Foundation. Its first 30 were good, and its second 30 were good. You will have to go on and meet the next challenge of justifying your continued existence.

Dr. KNOWLES. Absolutely.

Senator HARTKE. And that is very simply—I just doubt whether or not that you have the capacity. I am not saying I do. What people will be saying is: “I doubt whether this foundation has the capacity to really continue to perform a useful social purpose.”

Dr. KNOWLES. You doubt that the foundation has?

Senator HARTKE. No; I am not saying that. I am saying that is what people under 30 will say.

Dr. KNOWLES. Oh.

Senator HARTKE. I think that there is a question whether or not you answer to me, you are going to answer it one of these days.

Dr. KNOWLES. Absolutely.

Senator HARTKE. And the difficulty is that I think that to go ahead and say look how good we are, I am just going to say that the pearly gates may say, yes, but you committed murder on the last day on earth, and I am sorry, that condemns you to the seventh level.

Dr. KNOWLES. Well, I certainly agree with you, Senator, completely. I feel very strongly that you cannot live on the past. I certainly would not apologize for the past of the Rockefeller Foundation, but it is the future we are contending with and certainly it is an age of doubt. It is also an age of profound anxiety when nobody seems to have much confidence in anything. Something like 20 percent of the people have confidence in Government; another 20 percent have confidence in business, and I am sure that most of the people in this country do not even know what foundations do, so therefore it would seem to me, they would automatically vote against them.

You ask about our philosophy. We do have a relatively simple philosophy. It adheres to the notion that education and the advancement of knowledge are absolutely fundamental to progress and reform, that the proper dissemination and utilization of knowledge is equally fundamental to progress and reform. If I had to describe our philosophy in absolutes, I would say that we are pragmatists; this is a peculiarly American philosophy that says, if it works, it is true.

That does not mean that we are valueless by any matter of means because we set our priorities on what we think people value or should value. For example, we have elected to go back heavily into the humanities and to keep on with our programs which relate to minority groups and equal opportunity, even though it has not been very popular in the public arena over the past several years. We adhere to a simple philosophy that the truth will out and will save us all, if we can find the truth. The truth is of course plural and contingent and forever in the making; we are never going to find it by ourselves, but we have as fine an opportunity and privilege to add to that thing called America for the future as any other organization. Certainly I

think we have to justify our existence, and certainly I think it is going to be ever so much more difficult.

Now, of course, there is a tendency of people when they get frustrated (and we have been doing this for the last 40 years) to look to Government for our salvation; I think we do that at our peril, quite frankly. Monolithic government and legislation and taxation are not what made this country great; they are not going to save this country. We need both a strong Government and a strong pluralistic private sector of people regionally determining their own needs, solving their problems, with individuals feeling that they, as individuals, have as important a role to play as you do in the U.S. Senate.

We do not have the leaders today who are telling us the solutions to our problems, and we have a suspicion of the established institutions, which in the 1960's perhaps were raising too much hell in one way or another; and we have been through a lot of turmoil, but our philosophy continues to be based on the fact that education and knowledge are fundamental to progress.

Senator HARTKE. Let me say, Dr. Knowles, you are one leader which we respect, and we appreciate your statement today, and we are going to be very pragmatic today and say that some of you might want to go to lunch, we will reconvene these hearings at 2 o'clock this afternoon.

[The prepared statement of Dr. Knowles and material previously referred to follows. Hearing continues on p. 74.]

PREPARED STATEMENT OF JOHN H. KNOWLES, M.D., PRESIDENT, THE ROCKEFELLER FOUNDATION

The Rockefeller Foundation was incorporated by an Act of the New York State Legislature in 1913. Its statement of purpose was encompassed by the single phrase, "To promote the well-being of mankind throughout the world."

Last year we celebrated the sixtieth anniversary of The Rockefeller Foundation. The contributions of the Foundation are on the public record. The achievements of the past, especially in public health and medicine and recently in agriculture, would have been impossible without adherence to the basic philosophy—emphatically stated by John D. Rockefeller, Sr. in 1907, that "The best philanthropy is constantly in search of the finalities, a search for cause, an attempt to cure evils at their source." While no institution can address, let alone solve, all the world's problems, the objective of the Foundation has been to select problems which lie at the root of human difficulties. By careful definition of goals and concentration of efforts sustained over long periods of time, the Foundation's aim is to contribute to the positive solution of problems, largely through the acquisition, transmission and utilization of knowledge.

The history of The Rockefeller Foundation spans an era of turbulent change—world wars, depression, vast revolutions in technology and global relationships. One clear lesson of this history is that there are no final solutions to man's basic problems. To carry out its original mandate, the Foundation has constantly reviewed and regularly revised its priorities and goals. During changing economic times, it has used its resources to balance the demands of an urgent present with the obligations to preserve its financial capacity to deal with the increasingly complex and threatening problems of the future. We have just completed one of the most extensive and intensive reviews in the history of the Foundation. The results of that review entitled *The Course Ahead* are appended to this statement.

*Financial History*

The Rockefeller Foundation (1913) and the Laura Spelman Rockefeller Memorial, established in 1918 and consolidated with the Foundation in 1929, have over the years received from John D. Rockefeller, Sr. and his family gifts of money and securities amounting to \$258,060,599, taking the securities at their market value when received. From 1913 to the end of 1973, The Rockefeller Foundation paid out, in furtherance of its philanthropic purposes, a total of \$1,185,-

291,826 which was \$248,087,983 in excess of its income for the period. In spite of drawing upon capital for this excess, the Foundation's security holdings on December 31, 1973 had an aggregate value of \$829,786,159.

This record is testimony to the prudent and capable stewardship of those who have been responsible for the handling of the Foundation's financial affairs since its creation over 60 years ago. Although financial policy has of necessity varied to some extent over the years in response to changing conditions, one basic and constant policy has been the willingness to make expenditures out of capital in order to respond to opportunities of major importance for the well-being of mankind.

The pattern of expenditures over time, as well as the aggregate sums, directly affects the effectiveness of the Foundation programs. The general development of grants in a program area has been based on intensive study by the staff and modest exploratory expenditures, followed by increasing support as the record of accomplishment has warranted. Frequently we make grants over a three-year period with the entire amount being funded in the year the grant is made, so that diverse economic conditions in the following years do not jeopardize our continuing commitment. Withdrawal from a project involves a tapering down of contributions over a period of years so that alternative sources of support can be developed if the effort is to be sustained on a continuing basis. It is important to understand that one of our major functions is to institutionalize advances so that other sources of support can take over.

It is not our function over time to substitute for the responsibility of others, public or private, nor is it our function or within our capacity to take up the slack of public expenditures during cutbacks in governmental funding.

If the Foundation were closely to follow fluctuating conditions on the stock market in determining expenditure levels, the changes would be precipitate and disruptive of the essential process of program development. Therefore, the Foundation adopted a policy in 1968 of setting each year's appropriation guideline equal to 5.75 percent of the average annual market value of its assets over the preceding four years. This policy smooths out the sharp year-to-year fluctuations in annual appropriations which would exist if the spending guideline were calculated on the basis of a single year. Appropriations as a percentage of the market value of the Foundation's assets averaged 5.8 percent over the last five years as opposed to 4.5 percent for the prior five-year period—see Table I. Moreover, the pattern of appropriations has been significantly more stable than the market value of the Foundation's assets.

#### *The Impact of Current Economic Conditions*

Senator Hartke convened these hearings to explore the impact which the current economic crisis is having on foundations and the recipients of foundation grants.

The current period of "stagflation" has imposed a double burden on foundations. The decline in the value of equity securities has been over one-third since the beginning of 1972. Although there are some variations in the severity of the losses, no foundation portfolio managed according to accepted fiduciary principles has escaped the widespread decline in the equity markets. The foundations' capacity to continue performing their charitable role has been even more gravely eroded by continuing inflation which has now reached the double-digit rate. Our "money power" has been eroded both by the effects of inflation on our grant recipients and the absolute increase in the cost of solving complex problems. Larger numbers of scientists and technicians, teamed in interdisciplinary efforts, are needed to research and solve the problems confronting mankind today.

The Rockefeller Foundation's portfolio fell in value from \$968 million in 1972 to \$645 million at the end of October, this year (see Table I). Although the magnitude of the loss is unprecedented, the Foundation's assets were lower than the current level as recently as May 1970. Recognition of the inherently cyclical nature of security portfolios prompted the adoption in 1968 of the formula for calculating spending guidelines on a four-year moving average. The Foundation's spending guideline for 1974 was \$45.9 million (\$47.3 less 1.4 million excise tax on net income) and the recently calculated guideline for 1975 is \$45.0 million (\$46.4 less 1.4 million excise tax).<sup>1</sup>

<sup>1</sup> The estimated appropriations for 1974 in Table I exceed the 1974 spending guideline because of the higher administrative costs caused by inflation and the costs of relocating the New York office of the Foundation as required by the Tax Reform Act of 1969.

The above method of calculation permits the Foundation to moderate the immediate impact of the sharp fall in its assets upon its recipient organizations. We believe that stability in our support during these particularly dismal times, when other sources of funding are shrinking, affords us untold opportunities to justify our existence. These are not the times for foundations, in particular, to retrench.

But neither The Rockefeller Foundation nor any other private foundation can long sustain its level of support for charitable purposes if the present stock market decline is not reversed. The burden is particularly destructive for institutions such as the private colleges and universities which depend on philanthropic and endowment sources for 27 percent of their income. The economic slowdown is seriously contributing to the present plight of private institutions in our society at a time when their services are so critically needed. We lose the pluralism and heterodoxy of private institutions at our peril.

In outlining the effect of the present economic crisis upon our recipient organizations, I should explain that The Rockefeller Foundation seldom provides general operating support for a research institute or a university. Typically, an institution will approach the Foundation for support of a new effort which it is committed to undertake. If our review indicates that the project is central to our program guidelines and the institution has the capacity to implement it successfully, we may agree to provide the amount of support necessary to carry it out. This policy permits the Foundation to direct its limited resources most effectively toward what Theodore Hesburgh, Trustee of The Rockefeller Foundation, has called "the heart and substance of problems."

The level of Rockefeller Foundation support, therefore, does not directly affect the general operations of recipient organizations. It does affect their capacity to undertake new initiatives. Economic conditions will not cause the Foundation to abandon projects which its support has helped to launch, but assistance for new projects to address domestic and global problems will have to be curtailed unless economic conditions during the coming year restore our earning capacity.

The burden of inflation upon us and our recipient organizations, both here and in the less developed countries, has been even more onerous than the loss in value of the Foundation portfolio. It has been widely recognized that wages have been rising faster than productivity in the service sector of the economy. Costs per unit of output for foundation-supported activities have risen persistently and cumulatively over time; we have accepted an estimate that the costs of foundation-supported activities have been rising at least 2.2 percent more rapidly than the Consumer Price Index. This means that the 1978 value of a charitable organization's income would be equal to only 54 percent of its 1964 value, and this does not include the impact of 1974's double-digit inflation!

But inflation simply measures the increasing cost of doing the same thing, at a time when the old technology and traditional approach to the solution of human problems are clearly inadequate. Multi-disciplinary programs, utilizing the full range of modern technology, are enormously expensive—but they are essential if an effective attack is to be made on the increasingly complex problems of an interdependent world. Present inflation drastically erodes the capacity of our private and public institutions to deal adequately with these problems.

#### *Specific Recommendations*

In response to Senator Hartke's invitation of July 1, 1974, The Rockefeller Foundation submitted a written public statement, dated July 25, 1974, concerning sections 4940 and 4942 of the Internal Revenue Code. These two provisions impose a 4 percent excise tax and a minimum distribution of income requirement on private foundations. I would like to restate our views on these two subjects since they are squarely within the agenda of the Subcommittee's present hearings.

We endorse the recommendation made by Senator Hartke and other members of the Subcommittee, printed in the Congressional Record of October 4, 1974, that the level of the excise tax on private foundations be reduced from 4 to 2 percent.

The Subcommittee is familiar with the factors which favor such a reduction. We feel that it is entirely appropriate for private foundations to bear their share of the Internal Revenue Service's increased cost of enforcing the provisions of the Tax Reform Act of 1969. The fact that the anticipated revenue from such tax at the reduced rate of 2 percent will be more than adequate, even at current inflation rates, to defray the Internal Revenue Service's cost of auditing foundations and all other exempt organizations argues strongly for such a reduction.



The burden of the excise tax falls directly and fully upon the recipients of foundation grants. If the tax is reduced, each foundation would be required, under Section 4942(d), to make distributions for charitable purposes in an amount equal to the savings in tax.

In the case of the Rockefeller Foundation, a reduction in the excise tax would provide a significant saving. The 4% excise tax has resulted in taxes on the Foundation for the last four years in the total amount of \$7,042,800.

For all foundations, the estimated savings, based on revenues derived from the 4% tax during 1973, would insure the availability of approximately \$40 million per annum for charitable purposes at a time when many educational, scientific, and other charitable institutions in the private sector are finding it increasingly difficult to continue their programs at current levels.

We also suggest the desirability of redesignating the tax as a supervisory fee to confirm the purpose of the assessment. This would be consistent with the historic principle that charitable organizations in the United States have been exempt from Federal taxation.

Notwithstanding its long-standing policy of making distributions for charitable purposes substantially in excess of its investment income, the Foundation believes that the present level of the mandatory payout requirement under Section 4942(e)(3) may permanently weaken the ability of private foundations to support charitable programs at current levels.

As has been stated, this Foundation has followed a policy for many years of appropriating funds for grants, programs and administrative costs substantially in excess of its income. Although the Foundation has for a number of years voluntarily made distributions at a level comparable to the statutory payout requirement, we would now be obliged, but for the mandatory requirement, to consider the effects of inflation and erratic investment conditions on our ability to continue distributions at such a level.

In 1969, when the Tax Reform Act was under consideration, the recent history of inflation rates, and prevailing expectations concerning future rates of inflation, were in the range of zero to 3 percent. The requirement for a minimum payout of 6 percent based upon average market conditions at that time appeared reasonable. At the current time, however, worldwide rates of inflation have reached or exceed 10 percent per year. These increases have greatly outstripped any prudent long-run investment returns and have indeed borne a marked negative correlation to the value of equity investments. While it is true that bond rates have risen in the wake of mounting inflation, it would be unrealistic to expect sizable investment portfolios to shift from equities to bonds rapidly without serious trading losses and substantial transactions costs. It is therefore especially critical, given the current state of the country's and the world's financial condition, that the inflation factor be taken into account in arriving at a meaningful payout requirement.

In determining the payout requirement for 1974 and later years, the Secretary of the Treasury is required by Section 4942(e)(3) of the Code to take into account "the relationship which the money rates and investment yields for the calendar year immediately preceding the beginning of the taxable year bear to the money rates and investment yields for the calendar year 1969." Although a comparison of money rates in 1973 to those existing in 1969 might be said to justify the increase of the payout requirement to 6 percent, a similar comparison of investment yields, taken on a total return basis, clearly indicates the need for a *reduction* in the payout requirement.

The Treasury has not indicated what factors were deemed relevant in the determination of the payout requirement for any given year, and specifically whether any consideration was given to recent negative investment yields on equity investments or to the effect of inflation in comparing the investment yields in question to those existing in 1969. In any event, the current administrative practice results in the imposition of a level of payout requirements which could lead to gradual liquidation of the charitable functions performed by private foundations.

At least for the foreseeable future, inflation is a fact of life that can no longer be ignored. From the point of view of private foundations, it has become a critical factor in determining the amount of annual expenditures that can safely be made without permanently damaging the effectiveness of their program activities.

The Rockefeller Foundation, therefore, also strongly endorses the recommendations made by Senator Hartke that Section 4942 be amended to give the public

an opportunity to comment on proposed changes in the percentage payout requirement and that the Treasury take into account total-return investment yields on equity investments as well as fixed income rates in determining the annual payout requirement.

We support the concept that foundations should be required to make regular and complete distribution of their earnings for charitable purposes.

But the payout requirement should be sufficiently stable so that foundations can plan for the management of their portfolios and the development of programs without the disruption of short-run changes. The extreme volatility of the market can be moderated by using a longer and broader base for calculating the required percentage. The best means of accomplishing this would be to adopt a standard payout requirement related to the long-term rate of real returns on investments and calculated on the basis of a moving average of foundation asset values. Such a fixed requirement, in the range of 4½ to 5 percent, would not preserve the real value of foundations' assets during today's inflation, but it would represent a reasonable compromise between society's present and future demands upon their earnings.

### Conclusion

Whatever additional income the Foundation realizes, either from the specific changes recommended in the law or from a general revival of the economy, will be applied directly to the advancement of knowledge and its application to human needs. The Foundation has recently reviewed its programs and the Trustees have approved a commitment to concentrate our resources in seven areas of fundamental importance to mankind: The Arts, The Humanities and Contemporary Values; Conflict in International Relations; Conquest of Hunger; Education for Development; Equal Opportunity for All; Population and Health; Quality of the Environment. The full program statement, *The Course Ahead, The Rockefeller Foundation in the Next Five Years*, is attached as the appendix.

On the fiftieth anniversary of The Rockefeller Foundation, a former president, Raymond B. Fosdick, summed up the role of the Foundation in words which well describe the philosophy which guides us and the challenge which drives us on:

The massive changes in the world today would have been incomprehensible fifty years ago—the unprecedented growth of the world's population, the frightening upsurge of nationalism, the billions spent in preparation for war, the enormous budgets for international aid—all of them involving sums so vast that Carnegie and Rockefeller would scarcely have been able to add them up.

It is to this incredible new world that our philanthropic foundations have to adapt themselves. The choices which half a century ago had to be made between competing projects seem, in retrospect, to have been unencumbered by anything except a desire for excellence. Today's choices have to be geared to this new moment in time when we cannot know with any degree of certainty whether the human race stands on the verge of utter catastrophe or on the threshold of a creative era of shining promise. . . .

But every year the task grows more perplexing, and the possible points of contact which private funds can make with fast-moving human problems become more difficult to discover.

It may be true that in this era of gigantic public expenditures, where most of the crucial decisions lie in the hands of governments, our approach to the difficulties of our time will have to be tangential; we may not be able to play any conclusive part. But more than ever I am convinced that our relatively small assets, if used creatively and imaginatively, can affect the whole atmosphere of our generation. They can maintain standards of excellence. They can help to enrich the work and lives of promising scholars and leaders in fields which public funds cannot easily or wisely enter. They can support projects behind which there is as yet no marshaled public opinion. More than anything else, perhaps, they can help, through research and demonstration, to relieve the strains and stresses of this dynamic age—by forward steps to increase the world's resources, for example, or by bringing to the less developed nations the educated leadership by which alone they can raise themselves to the economic and social levels of more fortunate peoples.

TABLE I.—THE ROCKEFELLER FOUNDATION, SELECTED FINANCIAL DATA, 1965-74

[Dollar figures in thousands]

	Total appropriations	Total expenditures	Market value of assets Dec. 31	Investment income	Appropriations as percent of—		Expenditures as percent of—	
					Asset value	Income	Asset value	Income
1965.....	\$33,876	\$30,314	\$850,868	\$29,137	4.0	116.2	3.6	104.0
1966.....	41,086	34,893	733,020	30,784	5.6	133.5	4.8	113.3
1967.....	38,774	36,349	802,233	32,188	4.8	120.5	4.5	112.9
1968.....	42,451	41,488	855,636	32,838	4.8	129.3	4.7	126.3
1969.....	46,825	38,721	755,586	31,977	6.2	146.4	5.1	121.1
1970.....	50,845	47,116	767,111	30,354	6.6	167.5	6.1	155.2
1971.....	41,085	43,885	830,569	27,947	4.9	147.0	5.3	157.0
1972.....	43,743	44,027	967,972	25,259	4.5	173.2	4.5	174.3
1973.....	43,141	44,446	829,786	28,916	5.2	149.2	5.4	153.7
1974 (estimate).....	48,636	50,390	644,835	35,805	7.5	135.8	7.8	140.7

1 Oct. 31, 1974.

### THE COURSE AHEAD—THE ROCKEFELLER FOUNDATION IN THE NEXT FIVE YEARS

THE ARTS, THE HUMANITIES AND CONTEMPORARY VALUES—CONFLICT IN INTERNATIONAL RELATIONS—CONQUEST OF HUNGER—EDUCATION FOR DEVELOPMENT—EQUAL OPPORTUNITY FOR ALL—POPULATION AND HEALTH—QUALITY OF THE ENVIRONMENT

### BOARD OF TRUSTEES—THE ROCKEFELLER FOUNDATION—1974

W. Michael Blumenthal  
Jane P. Cahill  
Douglas Dillon  
Robert H. Ebert  
Robert F. Goheen  
Clifford M. Hardin  
Ben W. Heineman  
Theodore M. Hesburgh  
Vernon E. Jordan, Jr.  
Clark Kerr  
Lane Kirkland

John H. Knowles  
Mathilde Krim  
Bill Moyers  
John D. Rockefeller IV  
Robert V. Roosa  
Nevin S. Scrimshaw  
Frederick Seitz  
Maurice F. Strong  
Cyrus R. Vance  
Clifton R. Wharton, Jr.

### TRUSTEE PROGRAM REVIEW COMMITTEE

Robert F. Goheen, *Chairman*  
Douglas Dillon  
Theodore M. Hesburgh  
John H. Knowles

John D. Rockefeller IV  
Robert V. Roosa  
Frank Stanton (retired)  
Cyrus R. Vance, *Vice-Chairman*

### FOREWORD

The energy crisis and the precarious state of the world's food supplies have forced the American people to face the fact that we live in an interdependent world. Similarly, this year-and-a-half of intensive program review has made it obvious to trustees and staff alike that all our interests and programs are interrelated and interdependent: increased food production and improved distribution will improve nutrition and health and enhance economic development which, in turn, will provide new resources with which to improve education in all its forms. All of which, in turn, should limit population growth and thus allow further resources to be devoted to improving the quality of life by developing institutions of health, education, welfare, and social justice. A new concern for humanity, spawned by the knowledge of the interdependence of all people and nations, may bring new sanity to a troubled world which, while it roams the brink of hell, may yet find the causeway to peace.

Although the world will always need and value the expert and the professional, it demands new interdisciplinary approaches to its problems that recognize the interrelatedness and interdependence of all knowledge and of human welfare. In the microcosm of The Rockefeller Foundation, we are searching for ways to bring our various experts into more fruitful tension with each other. We seem never to have enough time or money to do all the things we would like to do, and we live in a state of chronic frustration.

The process of review and evaluation is a continuous one as we search for the best ways to use our limited resources to reach our goals. Our sixty-year history tells us that we have contributed something of value. This encourages us and drives us on.

JOHN H. KNOWLES, *President.*

#### INTRODUCTION

The individual often has trouble knowing himself: where he came from, how he got where he is, what he must do next to survive, to grow, to be a useful member of the society.

Similarly, an organization may have difficulty defining its strengths, setting specific goals, and charting the paths to reach them. This is especially true of a foundation dedicated to the "well-being of mankind throughout the world."

Day-to-day changes in the Foundation's global surroundings and its people cause continual, sometimes unconscious, shifts in program direction. In time, the need for a formal review of both the program and its operation—of goals and how to reach them—becomes evident. That time is hastened by the acquisition of new leadership and an appreciation of the growing complexity of the constantly changing world.

With the election of a new Chairman of the Board, Douglas Dillon, and the arrival of a new President, John H. Knowles, in July 1972, a complete staff review was initiated. In December 1972, a Program Committee of the Board of Trustees, chaired by Robert F. Goheen, set to work on the first comprehensive trustee review since 1958.

The Committee's task was to review both existing programs and potential areas of new—or renewed—interest for the Foundation. As part of this task, the Committee drew on a thorough staff review that preceded it. The Committee worked with the President to formulate an updated definition of program objectives and operating guidelines for the Foundation in the mid 1970's.

The Board of Trustees has reviewed and approved the Committee's completed report. This published statement represents the conclusions of the Board on directions for the Foundation in the 1970's.

---

The Foundation's guiding philosophy seems sound. In 1909 John D. Rockefeller, Sr. said: "The best philanthropy is constantly in search of the finalities—a search for cause, an attempt to cure evils at their source." In 1972, trustee Theodore Hesburgh said that a foundation "should try to get at the heart and substance of problems rather than play around with peripheral realities and effects." In 1974, the Board as a whole reaffirms that view.

We recognize that no institution can address, let alone solve all the world's problems. Our aim is to contribute to the positive solution of problems that we have the resources to confront.

From the beginning, the Foundation has recognized that most of man's basic problems are global in dimension. Today, conflict, oppression, malnutrition, rapid population growth, ill-health, unemployment, poverty, ignorance, and inadequate educational and training opportunities continue to plague many parts of the world. If present population trends continue, about twice as many people will be competing for a diminishing resource base at the end of the century and contributing to pollution of water, land and air. Already looming is the very real prospect of large-scale starvation in some areas of the world. Coupled with this growth in population is a major transition from a largely rural to a largely urbanized society. In the developing world, where urban growth rates surpass anything ever experienced in the more industrialized countries, it is proving virtually impossible to provide even the basic minimum resources and services.

At home, major issues are inequality of opportunity reflected in inadequate access to education and training, health, and legal services. Chronic unemploy-

ment, abysmal health statistics, gross injustice to minority groups, steadily increasing crime rates, excessive inequalities in income and wealth, and rising welfare rolls remain grinding problems in our nation. We see our society shifting from an industrial to a service economy, but there are few apparent solutions to the complex social problems this change entails. Additionally, the quality of our land, air, and water is diminishing both at home and abroad.

In all these global and domestic problems, we come back to the need to focus on causes rather than effects, to remove the problems rather than continually deal with their consequences. The Foundation has always stressed the acquisition, transmission, and effective utilization of basic knowledge, and will continue to do so.

Despite the persistence and force of nationalism in many areas, including our own country, the Foundation believes all men will share a common destiny. This faith is reaffirmed in the continuation and expansion of our programs in the less-developed countries, and in new activities directed to the resolution of international tensions. We are both a granting and an operating foundation, and we have enjoyed certain successes with both ways of working. The Foundation's field staffs have contributed to improved public health and agricultural progress throughout the world. Its strategic cycle of scientific and technical advice by program officers or field staff, followed by grants, fellowships, the building or strengthening of institutions, is effective. The Foundation recognizes the critical importance to any society of educated *individuals* of high talent; it recognizes also that such individuals must have *institutions* in which to work if anything of quality is to endure and be strengthened through time.

It is increasingly apparent that many of the problems we are addressing require multidisciplinary approaches and that there are significant, potentially fruitful overlaps among various of the Foundation's program activities. Both in its internal organization and in its programs, the Foundation will give increased attention to these needs and opportunities.

Throughout its history, the Foundation has been careful to concentrate its efforts on selected programs with well-defined goals. Through the process of constant review we shall strive to avoid too much diffusion of effort.

---

With these general guidelines in mind, the Foundation will focus its activities in seven major program areas. Five are continuations of existing programs, with some important modifications. The other two—The Arts, the Humanities and Contemporary Values, and Conflict in International Relations—are in some ways revivals and enlargements of old interests, but represent significant new commitments.

The seven major program areas are: The Arts, the Humanities and Contemporary Values; Conflict in International Relations; Conquest of Hunger; Education for Development; Equal Opportunity for All; Population and Health; Quality of the Environment.

We see these areas in which we have chosen to work as parts of a whole. We shall continue to try to locate the neglected pieces and to work on those most urgently in need. We know that much is being done by others on which we can build, or which we can supplement or extend. Our aim is to form a comprehensive view as a basis for selection of problems which are within our competence and where our efforts may have multiplier effects.

---

Since its inception in 1913, the Foundation has expended more than \$1.130 billion, a total considerably in excess of the market value of the Foundation's assets, which as of December 31, 1973 were \$830 million.

In 1968 the Foundation decided to appropriate annually 5.75 percent of the average market value of its assets over the preceding four years.\* Applying

---

\*The Tax Reform Act of 1969 requires that the Foundation pay out, by the end of each subsequent year, all ordinary investment income, or, beginning in 1972, a determined percentage of the value of its marketable securities, whichever is higher. The percentage, determined each year by the Secretary of the Treasury on the basis of prevailing money and investment rates, is 5.50 in 1974 and could be as high as 6 percent or more in 1975.

that formula forward, it is estimated that \$220 million to \$270 million will be available for expenditures over the next five years. No firm forecasts can be made as to how these totals will be divided between the seven major program areas. Very likely as much as two-thirds will continue to be concentrated in the four areas where the Foundation has had its greatest recent commitments: Conquest of Hunger, Population and Health, Education for Development, and Equal Opportunity. But allocations in each area will depend on the specific program opportunities that emerge, and the relative claims of the several areas may alter as circumstances change.

THE TRUSTEES.

#### THE ARTS, THE HUMANITIES AND CONTEMPORARY VALUES

The Foundation has a long history of support for the arts and humanities. In the past decade, as far as the humanities are concerned, this support was muted while more pressing problems received attention. That same decade, however, has once more brought to the fore value issues and questions of judgment. No aspect of the Foundation's work is free of them. Therefore, renewed attention will be given to the humanities alongside a continuing active program in the arts. It is hoped that strong encouragement may thus be given to the illumination and enlargement that each can help bring to men's understanding of their nature and destiny in a late 20th century world.

#### THE ARTS

One of the historical roles of the creative artist has been to tap the deep currents of thought and attitude in a society and to bring fresh perceptions to its values, ideals, and aspirations. Working in abstractions of light, sound, movement, language or objects, his expressions can baffle contemporaries; yet, a subsequent generation may see the hallmarks of the period in those same works.

Times of social upheaval often promote vigorous activity in the arts, and the upheavals of the 1960's produced a time of artistic flowering in America. Moreover, institutions long content to play elitist roles began to respond to new public demands for broader access to the arts. A democratizing effect is noticeable. Increasingly, the arts are being perceived as essential grammar of the vocabulary of man and as urgently needed forms of communication. Financial support for the arts has increased dramatically—although not enough. The artist has a long road to travel before his importance as a member of society, his function within that society, and the social and economic levels to which he may freely aspire are determined.

In selecting the key points of the Foundation program for the arts in the coming period, we have had in mind especially:

The importance of the artist to the development of a mature, receptive, sensitive, and responsive society.

The reality of professional life in the arts as one which still offers most artists odd jobs (if not unemployment) for sustenance.

The prevalence in too many schools of mediocre, or worse, opportunities for arts education.

The powerful impact of television on our culture and the need for that medium to carry information of a stimulating esthetic nature.

The movement within the arts to blur lines of disciplines which formerly separated the performing artist from visual artists, writers, poets, and composers.

The potential of the arts and the humanities for developing international awareness and intercultural understanding.

With these points in mind, the Arts program will work within the following specific areas of interest:

1. Making the arts more central to general education. This is a new program objective for the Foundation. It will include attempts to demonstrate the importance of the arts to human development and to promote an increased commitment to training in artistic skills within school systems. An initial step, already under way, is support of a study designed to determine for the first time what in fact is being taught in schools in the name of art. Particular attention will be directed to teacher-training institutions to strengthen and emphasize the preparation of arts teachers before they assume classroom responsibilities, a condition too often neglected in arts education.

2. Assisting creative artists. A continuation of our past policy of identifying talented artists and, through programs which address the needs of various disciplines, providing modest support for their creative work.

3. Institution building. A continuation of programs designed to assist existing institutions—such as theater companies, musical groups, centers for painting and sculpture—to take on new roles and to foster the establishment of new institutions where necessary.

In all of these undertakings, the Foundation will continue to emphasize the creative person's contribution to society and attempt to keep the artist central to all program endeavors.

#### THE HUMANITIES

In an increasingly technological and bureaucratic society, many look to humanities—and often too wishfully—for keys to lost human values. Scientists increasingly see the need to consider the impact of their work in human rather than solely technical contexts. Throughout our society the reemergence of themes like the meaning of justice, progress, liberty, the common good, and conscience has been pronounced.

Humanists are being challenged to enlarge and to deepen traditional ways of thinking in the face of:

The tensions between men's aspirations for personal freedom and the order required by technology, between experts and citizens, between faith in progress and fear of impending environmental and social breakdown.

Questions posed by advances in genetics and medical science to the meaning of fundamentals like life and death.

Spreading awareness of other, sometimes conflicting cultures alongside the western tradition.

New needs and opportunities for intellectual interaction across traditional disciplinary lines.

Moreover, many people feel excluded from the intellectual horizons of the college-educated, do not understand many terms of public discourse, and find their traditional cultural guideposts undermined. Humanities education for these men and women may become a necessary and fruitful undertaking. Such education would enlarge the humanities by engaging them in everyday perplexities.

Meanwhile, in resistance to empty meaningless uses of expanding leisure time, many cry out for beauty, for direct contact with nature, and for growth in humanistic pursuits.

As humanists respond to these demands and opportunities, a new creative period in the humanities may be in the making. To foster it, the Foundation will direct its support along three principal lines:

##### 1. Values, ideas, symbols, laws:

The major need in the humanities is at the deepest conceptual and imaginative level. The Foundation's main endeavor will be to identify and encourage talents of the highest order engaged in clarifying fundamental goals and values.

Our interest here is in the work of people of unusually great mental and spiritual capacity. They are confined to no single country or tradition. We shall support studies in all cultures and in communication between cultures.

Often, however, one individual alone is not enough; collaboration is required. On questions at the boundary line, for example, between medicine and ethics, law and moral values, politics and social justice, religion and spirit, business and the quality of life, support may best be given to an interdisciplinary institute or program. The Foundation will consider, and search out, such proposals.

##### 2. American identity—America's cultural heritage:

Many of America's people and regions are inadequately represented in the national consciousness. With encouragement to be more just and universal in their sympathies, scholars can enrich our understanding of our nationhood, draw upon overlooked cultural resources, and enhance the country's pride in its diversity as well as its unity.

Fellowships and institutional grants will be directed to scholars in fresh areas and among disadvantaged and neglected groups of Americans. Artists, writers, and scholars will be sought among groups that heretofore have received little encouragement that their experience and insights are valuable to all and contribute toward the enrichment of the common experience.

### 3. The public humanities—values lived and choices exercised:

Too often the word "humanities" is used only in colleges and universities. Yet human values, and concern about them, exist in the thoughts and actions of all people. The moral and cultural resources of families, neighborhoods, regions, and traditions need to be studied and strengthened.

The Foundation can signal the fruitfulness of this area by grants to individuals willing to develop appropriate means of inquiry. Initially two main ideas will be explored:

Less than half of young Americans go to college, but virtually all go to high school. In most high schools, the humanities are not integrated either with the sciences or with daily living. The Foundation will encourage educators who are trying to enrich the moral and philosophical content of high school programs.

Millions of men and women who have had no opportunity to attend college nevertheless want to be able to comprehend the world around them. Humanities education may help reduce social fear, while building a sense of dignity and liberating creative energies. The Foundation will encourage explorations and experiments in this field.

#### TELEVISION

The Foundation's interests in television center on uses of this powerful medium to encourage discussions, portrayals, and other presentations that commercial or public television might otherwise not produce.

In recent years, the Foundation has made significant contributions to the experimental uses of video by artists, humanists, and other non-television professionals. We intend to explore further how the medium can best be exploited in relation to each of the Foundation's program areas. But particular attention will be paid to its use relative to the Foundation's interests in the arts, humanities, and contemporary values.

#### CONFLICT IN INTERNATIONAL RELATIONS

Based on the Foundation's long experience in furthering the well-being of mankind throughout the world, this new program is sparked by the growing interdependence of men and nations and by the potential for conflict which that interdependence sometimes exacerbates.

Major developments that unite mankind and at the same time give rise to new competition and the possibility of new conflict include:

The rapid pollution of the seas, along with possibilities for exploiting the resources of the seas and the ocean floor, illustrates the possibilities for both cooperation and conflict among nations.

The phenomenal growth in the consumption of energy resources and minerals by the developed countries, coupled with the depletion of their own natural reserves, makes them increasingly dependent upon the less-developed countries and more competitive with each other.

The unfolding environmental crisis has brought to the fore further potentialities for conflict among the industrialized countries, among the less-developed countries, and between industrial and less-developed nations.

The rapid expansion of world trade is creating a progressively interdependent international economic system. Production of many goods is being internationalized; multinational corporations are proliferating. The international monetary system and the many regional economic organizations also contribute to a complex political economic matrix.

The technological revolution has had a resounding impact on social and political institutions, international and national. Advances in weapons and warfare, in communication and transportation, in methods of production, in computers, and in medicine and agriculture have altered traditional institutions and relationships.

Coincident with this growth of global interdependence, there appears to be in the United States increasing disillusion with the complexities of the world and with the failure of past American efforts to achieve many international political and economic objectives. Fortunately, at the same time, among thoughtful citizens—including many who are young—there is a disposition to reach beyond past attempts at simplistic solutions to a recognition of the interdependence of men and nations and of the complexities that entails.

The Foundation has a continuing interest in the development and maintenance of international order. Its mandate to work for the "well-being of mankind" calls



for efforts toward the survival of men and their civilizations. The achievement of the Foundation's other goals depends on peace and international cooperation.

The Foundation has in the past supported scholars and institutions working in international relations. The support available from other sources now appears to be far less than adequate to the needs and the opportunities for research, communication, and institution-building in this field. The activities of the Conflict in International Relations program will, therefore, be governed by four main objectives:

To identify and assess emerging areas of international affairs which are likely to be of major importance in the next decade.

To encourage the development of new ways to conceptualize these problems by organizations which have competence in the field.

To promote an interest in international affairs among a larger proportion of the world's citizenry.

To help develop additional expertise in international affairs.

The program designed to realize these objectives will:

1. Support the work of talented and promising scholars and participants in world affairs through an experimental Rockefeller Foundation Fellowship Program in Conflict in International Relations centered on problems which are likely to be of international importance in the next ten years.

2. Support—and in some cases initiate—efforts to promote a wider and deeper public understanding of international affairs to counteract the sense of hopelessness about the effectiveness of measures to order the world. These efforts will be directed to educational, civic, professional, business, and labor groups in selected communities.

3. Support—primarily through other organizations—task forces of workshops which, over a sustained period, will concentrate on topics related to global interrelationships, to new international institutional arrangements, and to such problems as conflict anticipation and resolution. The seminars and workshops will be international, national, and regional in scope.

4. Support a small number of institutions working on high-priority problems which have the potential for disrupting the international community.

We will do what we can to encourage the development of trained leaders and to promote a wider appreciation of the critical nature of global conflict problems.

#### CONQUEST OF HUNGER

Two-thirds of the world's people live in the developing countries, and a majority of them are found in rural areas. Most depend on farms of a few acres. And most struggle for existence on incomes far too low to provide for adequate diets, let alone housing, health care, or education.

Despite considerable recent gains in farm productivity, world food production is still barely keeping pace with population growth. If population continues to grow at today's rate, and if the diets of the world's poor are to be improved even modestly, output will have to be more than doubled in the next twenty years. During the last two decades a substantial number of nations have shifted from food-surplus to food-deficit situations. There remain only a handful of countries with significant exportable surpluses; the poorer countries neither can nor should be dependent upon imports. Most must dramatically increase their own production. But, as the need to increase food production becomes more urgent, we are faced with the continued loss of productive soil and sources of water through encroachment of the desert, erosion, and salination.

The Foundation's efforts toward the conquest of hunger will be directed to the improvement of the lot of these poorest of the world's people—a most difficult task, considering that it entails efforts by more than 100 developing nations to effect changes on millions of farms and the development of institutions to train the people and create the technology for such a massive effort.

In the past, the Foundation has assisted with the development of technology and the training of scientists and technicians. Through these means, a rapid increase in the productivity of a few basic food crops has been achieved in some areas. Several country programs and international institutes, established with Foundation help, have been instrumental in assisting nations to increase substantially their production of crops such as rice, wheat, maize, and potatoes.

The Foundation's efforts will now be concentrated, with consideration both to needs for increased productivity and to concerns for preservation of the environment, as follows:

1. The world network of international institutes<sup>1</sup> and related international cooperative activities, now sponsored by the Consultative Group on International Agricultural Research, will remain central to the Conquest of Hunger program. Diversification and strengthening of the system, to include participation by relevant scientific and technological institutions in all countries, will be sought as a means of accelerating progress.

2. Continuing attention will be devoted to means of improving nutritional quality as well as yields of the basic food grains—including the cereals, legumes, and certain oilseed crops—and of intensifying their resistance to disease and insect attack. Programs to control plant pests and pathogens on a regional or global basis will be continued. Efforts to improve animal health and production will be intensified, especially in Africa and Asia. Emphasis throughout will be on the strengthening of the necessary science base and the training of research and production specialists.

The Foundation will encourage increased progress in these research areas through joint efforts of the international institutes and other centers, intensified pioneering work in universities, and occasional conferences among world authorities on specific scientific problems.

3. Support will be given to promising new research efforts in critical areas such as extension of nitrogen fixation to the grasses; creation of new crop species through the use of advanced techniques, including cell and tissue culture; new techniques and approaches in living aquatic resource development; production of single cell protein, especially from cellulosic crop residue and other organic substrates.

4. Assistance to nations or groups of nations, which give high priority to better organization for accelerated rural development is an urgent need. Three mechanisms are envisaged for Foundation involvement: to provide experienced consultants for limited periods of time; to provide qualified individual leaders for institutions in developing countries for more sustained periods; and to enable national and international leaders to improve their understanding of the development process through participation in workshops or conferences involving world authorities.

5. By concentrating on a few experimental and demonstrative rural development projects for selected populations and regions, the Foundation will help to identify strategies which can be employed, at reasonable cost, to improve the quality of life of the rural poor. Simultaneous attention will be given to problems such as small farmer income generation, health and family planning, education, housing, nutrition, and cultural values.

6. The Foundation will encourage the analyses of socio-economic aspects of food production and distribution, particularly in relation to small farmers and other rural dwellers. Issues needing attention include income sources and distribution, employment, marketing, credit, land tenure, farm mechanization, adoption of new production technology, and policies affecting trade, distribution, and storage.

Each nation's food production capabilities depend not only upon the development of improved farming systems and the training of personnel in substantial numbers, but upon commitments of governments to support of dynamic production efforts. It is necessary to organize more effective institutions, to see to adequate supplies of fertilizers and fuel, and to devise appropriate pricing and marketing arrangements, all in keeping with a prudent concern for the environment. The Foundation will seek to be helpful in international efforts to speed the strengthening of sound and effective national agricultural research and production programs.

<sup>1</sup> The International Rice Research Institute (IRRI), Philippines; International Maize and Wheat Improvement Center (CIMMYT), Mexico; International Center of Tropical Agriculture (CIAT), Colombia; International Institute of Tropical Agriculture (IITA), Nigeria; International Potato Center (CIP), Peru; International Crops Research Institute for the Semi-Arid Tropics (ICRISAT), India; International Laboratory for Research on Animal Diseases (ILRAD) Kenya; International Livestock Center for Africa (ILCA), Ethiopia; and the Asian Vegetable Research and Development Center (AVRDC), Taiwan.

### EDUCATION FOR DEVELOPMENT

There is a widely acknowledged crisis in education throughout the world. Its fundamental cause is the serious maladjustment which has arisen between the educational systems and the needs and aspirations of the societies which they are meant to serve. Nowhere is this maladjustment more evident than in the less-developed countries.

The Foundation's university development program, aimed at these countries, is guided by the premise that universities can be instruments for social and economic improvement.

1. The Foundation therefore will continue to emphasize the strengthening of selected institutions that show a capacity to be national and regional models. The objective will be to help the institutions to reach a level of excellence that can be maintained without further assistance from abroad. This point is being reached at several of the universities supported over the past decade. As Foundation assistance is phased out, work is beginning with other universities with similar promise. The Foundation will seek to effect improvements in the quality of education and research within these universities and, more importantly, to assist them to break out of their walls and extend their activities into the communities, confronting the real problems facing a nation in the throes of development.

Particular attention will continue to be placed on departments of agriculture, public health, medicine, and social sciences. Assistance will generally entail the provision of especially needed faculty competence and an extensive fellowship program for the training of present or projected staff.

2. This approach may be extended to departments of education. The problems of primary and secondary education in the less-developed countries become progressively more serious, limiting the number of candidates for higher education and thus for national leadership. Research involving the education departments of universities, together with model programs which can be tested, may demonstrate how to strengthen lower school systems.

3. Universities will also be encouraged to develop, on an experimental and demonstration basis, applied programs and extension activities adapted to the needs of their countries or regions. Such programs should provide a more rapid transmission of the knowledge and skills which apply to the real needs of the people.

The expanded dimension which the name "Education for Development" adds to the university development concept provides greater flexibility for meeting both institutional and national or regional needs.

### EQUAL OPPORTUNITY FOR ALL

Even while significant and far-reaching gains have been made by American minorities over the past decade, this progress has more sharply revealed the extent of the problems still confronting racial minorities and made it clear that major tasks lie ahead. Resistance and reaction are now all too apparent; at the least, they must not be allowed to turn the clock back.

The Foundation's program rests on these premises:

A society with basic rights protected for individuals from all racial groups remains an essential goal for the nation.

Special efforts need to be made to overcome the present effects of past discrimination. Identifying and training particularly talented men and women from minority groups, both at the highest level of individual accomplishment and within the framework of community development, demand priority.

A wide range of disadvantaged people should continue to be included within this program even though primary attention is given to American blacks.

Some attention must be directed to the plight of minorities in rural areas, though the Foundation's major involvement will remain in the urban area.

Based on these premises, the Foundation's equal opportunity objectives will be pursued as follows:

1. The program in community education and community development will be continued in the belief that a strong national educational effort, supported by the communities it serves, is the best means of moving those who are discriminated against into the mainstream of American life.

2. The leadership development program will be continued and strengthened. Through the use of internships which place talented people in the offices of top officials in educational and other institutions, the Foundation will work to identify, train, and then assist minority-group people to become experienced and effective in a wide variety of responsible positions.

3. A modest, policy-oriented research effort will be continued. Many questions concerning the problems of the disadvantaged remain unanswered, and private and governmental efforts to deal with them suffer from a lack of information about the causes of the conditions to be remedied. In pursuing answers to these questions, the desirability of identifying and encouraging the participation of minority-group scholars and scientists is evident.

4. The search for exceptional challenges and opportunities will go on. Several possibilities are being explored: the opportunity to help the increasing number of elected officials from minority groups; the special advocacy and litigation fields; and the exploration of other effective means for dealing with problems of persisting institutionalized racism.

5. In implementing our activities, attention will also be given to the plans and objectives of the stable and effective organizations that have been in the forefront of the effort in the equal opportunities field. The major contribution of the private black colleges will also continue to receive consideration.

6. A new component of the program, centered squarely on minority groups in rural regions will be explored. Building on past Foundation efforts, it may be possible to put together integrated programs dealing with the wide range of economic, health, education, demographic, and other problems of rural development. Special attention will be given to human resource development and to strengthening a few selected institutional capabilities to deal with these problems. Initially, attention will be focused on the Southeast.

#### POPULATION AND HEALTH

The Foundation has long been concerned with public health, medical education, and the biological and medical sciences, beginning in 1913 with the original International Health Board.

Since 1963, as a result of vastly increased governmental financing of the biological sciences, the Foundation's support in that area has been confined largely to reproductive biology. At the same time, the Foundation decided to direct major attention to population growth as one of the problems expected to be critical for human well-being in the coming decades.

Recognizing the interrelationships between questions of population and of health, the present Population program will be renamed Population and Health, and the title of the Biomedical Sciences Division will be changed to Health Sciences, to facilitate the realignment of our existing programs and the exploration of additional opportunities.

#### POPULATION

Since 1963, the Foundation's population program has been striving toward the goal of population stabilization through support of basic research in reproductive biology, applied research in contraceptive technology, and research on the relation of social, psychological, and economic considerations to the question of family size.

There has been a remarkable growth in public awareness of the problem and greatly increased efforts by governments and private organizations to find solutions through family planning programs and research in reproductive biology and in the social sciences. Family planning programs can now generally be left to the support of governments and international agencies. On the other hand, population research in both the biological and social science fields continues to be seriously underfinanced. Thus important opportunities exist for the Foundation in the support of such research.

Therefore:

1. The recent policy of increased emphasis on the support of research in social sciences relevant to population issues will be continued. Particular attention will be directed to the economic, human development, and social factors which act as determinants of family size. The relationship of the degree of economic development of particular societies to population growth rates will also be studied.

2. Support will be increased for basic research on the complex chain leading from gamete formation to establishment of pregnancy, primarily through assistance to university-based investigators.

3. Applied research in contraceptive development will be encouraged.

4. To aid basic and applied research by increasing the possibility of interaction between researchers and clinicians, assistance in the establishment of research positions in departments of obstetrics and gynecology will be continued.

5. The current postdoctoral research fellowships will be maintained.

6. Efforts to encourage teaching of population-related matters at all levels from the grade school through medical school will be continued, as will programs for training personnel for family planning services. Both will be pursued on an international basis.

#### HEALTH

The major commitment will continue to be in population as a prime determinant of health, but we shall renew and expand our traditional, broader interest in health. We plan major new efforts in the improvement of health care delivery systems, with specific reference to the less-developed countries. Public health programs have not received the emphasis they deserve in the less-developed countries, partly due to the feeling that economic development per se will "trickle down" and improve health. Economic planners, and populations at large, do not place health in its proper context; recent development planning has not been integrated to include health. Whether on moral or humanitarian grounds, or purely utilitarian and practical grounds, this defect can no longer be defended.

The Pearson report to the World Bank in the early 1970's, entitled "Partners in Development," almost totally neglected the relationship of health to economic development, whether in the adverse effect of ill-health on development or the inadvertent intensification of health problems through the development process. In the first instance, the inability to develop the fertile lands along the Volta River, due to the presence of onchocerciasis, led the World Bank to organize a consortium of agencies to eradicate the disease as the first step in development. In the second instance, the development of hydroelectric power stations and drainage and irrigation systems has spread the transmission of such diseases as schistosomiasis and malaria—either directly, through the new water systems, or through the massive relocation of human settlements to regions previously uninhabited.

Continued efforts to reduce and stabilize the world's population must include attempts to reduce infant mortality. Of the world's 60 million annual deaths, it is estimated that 30 million occur in children under the age of five years. Families in the less-developed countries may suffer 50 percent infant mortality rates and, therefore, have many children to ensure a sufficient number of survivors, who provide their only form of social security. High morbidity and mortality are due primarily to communicable diseases sown on the fertile soil of malnutrition.

It is clear that a substantial effort in health—directed primarily at problems of providing potable water, sewage disposal, immunization, adequate caloric and protein nutrition, and the production of medical auxiliaries—is needed to create the conditions required to: (1) make high fertility disadvantageous to the individual family, (2) remove barriers to primary education, (3) improve the productivity of existing human capital, and (4) facilitate economic development without intensifying public health problems.

Involvement in the improvement of health care delivery systems will be confined to our overseas operations, since within the United States these problems are now the prime concerns of a number of other large foundations, as well as government at all levels. The renewed emphasis on health will be pursued not in isolation but in close conjunction with other major Foundation programs.

Education for Development: The most important contribution to the health of people in the less-developed countries is to introduce simplified methods of delivering health services, concentrating on the relatively simple factors that are the chief causes of morbidity and mortality. This goal requires the training and extensive deployment of health auxiliaries at a number of levels—no easy matter. Training will require the type of experimentation and demonstration which the Foundation can best assist through its own field staff. The Foundation's past experience in the development of community medicine programs connected with

university centers in various parts of the world will be useful in this context; support for this type of program will be extended.

**Quality of the Environment:** The Population and Health program will be concerned with those undertakings in which the Quality of the Environment program deals with toxic pollutants and other factors which constitute health hazards; basic research will be emphasized. The possibility of training physicians in environmental medicine will be explored.

**The Arts, the Humanities and Contemporary Values:** The range of ethical moral, and value issues as related to scientific advance and the use of medical technology needs intensive study. Likewise, in proposing population and health programs to less-developed countries, methods must be developed to minimize conflicts between cultures.

**Conquest of Hunger:** Population and Health will take part in the health, nutrition, and family planning components of any rural integrated development project which is supported under the Conquest of Hunger program.

**Tropical Medicine,** with special reference to Schistosomiasis: We plan also a modest exploratory effort in the field of tropical medicine, with specific reference to basic research in the major human parasitic diseases indigenous to the tropical regions of the world. A center in a United States medical school for research and postgraduate training in tropical diseases is being established with Foundation support. A program to study control of schistosomiasis began in 1967 on the island of St. Lucia. Early results are encouraging. The Foundation is also supporting basic studies in other locations on the snail vectors, new drugs, and immunology. There are at least 200 million people afflicted with schistosomiasis, and some observers believe the figure is closer to 300 million. The disease is prevalent in Africa, the Middle East, Brazil, several Caribbean islands, China, Thailand, and the Philippines; and it is spreading because of the altered ecology of hydroelectric, drainage, and irrigation development.

Most of the new programs under consideration involve pilot-scale demonstration projects and can be achieved at modest cost. They offer opportunities to carry forward the Foundation's long tradition of work in population and health, especially in the less-developed parts of the world.

#### QUALITY OF THE ENVIRONMENT

Man's increasing capability to mass-produce energy and goods, his evergrowing consumption of the earth's resources, and his increasing numbers have multiplied the size and severity of the world's environmental problems. But conflicts over solutions to these problems have arisen between those concerned with environmental protection and those favoring an expanded economy. For one urgent example, the task of increasing food production faces a constraint in the damage to environment and to health that could result from vast increases in the use of chemical pesticides and fertilizers.

The goals of the Foundation's Quality of the Environment program are to speed the solution of important environmental problems, and in so doing to assist in the creation of institutional capabilities to deal with them, and to build better bases for public understanding of environmental issues.

To these ends, five types of activity have been chosen for support from the Foundation:

1. Cooperative efforts by public and private organizations which are searching for solutions on an interdisciplinary basis and addressing themselves to specific environmental problems with biological, economic or other social components. The increased importance accorded environmental issues has caught major segments of the scientific community ill-organized and inexperienced in dealing with complexities which require coordinated efforts by specialists in diverse fields. Many universities have their expertise scattered over many departments and faculties. There is little tradition behind close collaboration among diverse disciplines. Thus, both conceptual and organizational difficulties in dealing with environmental problems on an interdisciplinary basis must be overcome.

2. A comprehensive environmental study of the New York City metropolitan area and the area to the north (the Hudson Basin). This study will involve the cooperation of scientists and other specialists in the region. Its outcome should reveal the status of knowledge of the region, indicate priorities for research, and point the way toward methods of cooperation among institutions and individuals for anticipation and resolution of environmental issues. Depend-

ing upon accomplishments, regional studies of this sort may become a major thrust of the Quality of the Environment program.

3. The development of understanding of environmentally significant alternatives in the management of both toxic pollutants and nutrients affecting the quality of ground and surface waters, the productivity of land, human health, and the survival of biological communities. This will include a search for better understanding of the major food chains. These interests will be developed in conjunction with the Conquest of Hunger program.

4. International collaboration on environmental problems. Some major differences in priorities between more- and less-developed nations emerged in the Stockholm Conference on the Human Environment. Many of the problems are of such magnitude and complexity that major responsibility for their solution must rest with United Nations organizations and with governments. The uses and management of the oceans and their living resources is emerging as just one of the major challenges facing the world community. However, there remains a need for private organizations to help develop linkages among the world's institutions and scholars through unofficial multilateral conferences and the sponsorship of studies under nonpolitical auspices. This interest will be developed in conjunction with the Foundation's Conflict in International Relations program.

5. An improved understanding of the nature and sources of public perceptions of environmental problems through careful, sharply focused opinion studies. The results should assist both the Foundation and public action agencies to identify major gaps in public understanding and enable public agencies to pursue activities that will lead to a better informed citizenry.

#### CONCLUSION

The general objectives and chosen areas of activity described in this report are the result of a year and a half of prolonged and intense thinking, discussion, and planning by the officers and staff of the Foundation and by its Board of Trustees.

In that process of review, of evaluating what has been done and planning for what is to be done, we were continually guided by the commitment to service which motivated the men who launched the Foundation upon its course. In 1900, John D. Rockefeller, Sr., signed a deed of trust which first set forth the purposes of The Rockefeller Foundation: "To promote the well-being and to advance the civilization of the peoples of the United States and its territories and possessions and of foreign lands in the acquisition and dissemination of knowledge, in the prevention and relief of suffering, and in the promotion of any and all of the elements of human progress."

That mandate was shortened in 1918 to become: "To promote the well-being of mankind throughout the world." Throughout its history since then, the programs which the Foundation has designed and supported to carry out that purpose have been shaped by the condition of the world: the phenomenal industrial growth in this country and Europe and the consequent social problems, the two World Wars, depression, famine, the emergence of newly independent nations and their rising expectations, the increasing interdependence of the world, the denial of equality to disadvantaged persons and their drive to secure it.

The review just completed was substantially influenced by events and upheavals of the past decade calling for fresh solutions and fresh ways of thinking. At the same time, the expansion and proliferation of social programs by governments led some Americans to question the role of and the need for private philanthropy. They doubted the efficacy of pluralistic approaches and challenged the propriety of tax exemption for voluntary initiatives. On the occasion of the fiftieth anniversary of the Foundation, in 1963, the trustees spoke of the unique place in society of the private foundations:

"The role of a private foundation is in meeting contemporary human need. A private foundation can take initiative; it can pioneer; and by mustering available knowledge and human competence, it can identify causes and experiment with solutions. It can move without the political complications created when governments are involved with other governments. It can encourage cooperative effort across national and political boundaries. It can bring a high order of individuality and diversity of viewpoint into the field of human betterment. It can provide a decentralization of social initiative and responsibility. And it can

enlist the interest and support of vigorous, enterprising, and public-spirited benefactors."

We believe that this statement is as true today as it was then.

More recently, the revelation of abuses of the tax exempt privilege by a few foundations led to widespread criticism of the roles of all foundations, as well as some plain misunderstandings of their assigned functions. This culminated in Congressional hearings and the passage of the Tax Reform Act of 1969 to correct these abuses. The standards imposed by that Act are constructive and are eliminating the abuses which were of concern to many officials of American foundations. But, in some quarters, misunderstanding and criticism continue, in large measure because most people are ill-informed about what foundations are and what they do.

The Rockefeller Foundation has, since its beginning, accepted an obligation to tell the people of the United States how and why it spends money the way it does. But it is plain, given the continuing public misunderstanding of the functions of foundations, that much remains to be done. To help alleviate this situation the Foundation is spreading the knowledge of its efforts to a substantially larger public than it has in the past and will, in the future, distribute even more widely a full accounting of its work.

The Foundation can be proud of what it has accomplished. But this painstaking review by both staff and trustees has shown us that we have much more to do to improve our work, to fit it to the ever-changing, ever more complex problems of the nation and the world. If we can accomplish this, we will more effectively reach our goal of promoting "the well-being of mankind throughout the world."

[Whereupon, at 1:10 p.m., the subcommittee adjourned, to reconvene at 2 p.m. the same day.]

#### AFTERNOON SESSION

Senator CURTIS (presiding). The committee will come to order.

Our next witness is Robert Goheen, chairman of the Council on Foundations.

Do you have a prepared statement, Mr. Goheen?

#### STATEMENT OF ROBERT F. GOHEEN, CHAIRMAN, COUNCIL ON FOUNDATIONS

Mr. GOHEEN. Senator Curtis, I do have a prepared statement, but in order to stay to my allotted 10 minutes and because a number of other people will be speaking more fully about most of the points I wish to cover, I shall be summary and brief.

Senator CURTIS. All right. Your entire statement will be reproduced in the record.

Mr. GOHEEN. I do welcome the opportunity, sir; to appear here and comment on the impact of the current economic situation on foundations and foundation beneficiaries and to speak to some of the policy issues that are highlighted thereby.

With the steeper turndown of the stock market that has occurred over the past 12 months or so, as you are aware, many foundation portfolios, including many that are broadly diversified, have declined sharply in values. A recent sample survey conducted by the Council on Foundations involving 30 sizeable foundations showed them to have had \$10.87 billion in assets at the end of 1978. Eight and nine months later the figure was \$8.04 billion, a decline of 26 percent overall for the sample.



Incidentally, that \$2.8 billion drop in asset values is somewhat more than all estimated foundation giving for all purposes in 1973, an amount which was estimated at \$2.38 billion.

Fortunately, so far, most of these are paper losses because earnings and investments generally have held up well to date. A comparison of adjusted net income figures for 1973 and 1974, for a sample of 21 foundations, shows an overall estimated increase of almost 4 percent and in only three cases is income for 1974 expected to be less than in 1973. That is, of course, without taking into account the effects of inflation on what the foundation dollar can do.

In these circumstances and because of the beating that grantee organizations are taking from current inflation rates, some foundations are seeking to maintain past levels of giving and even to increase them despite the market decline.

In other cases, to offset the shrinkage of assets, foundations are planning to expend no more than the law requires in the remainder of this year and in 1975. This will generally mean lower levels of grant-making than had been planned or would have been thought to be required a year ago.

The erosion of assets is particularly telling in the case of foundations that have in the past regularly made contributions considerably exceeding the legal requirement. When asset values plummet, as they have, you can see that a distribution of what was last year say, 8 percent of assets, can become 12 or 14 percent or an even higher percentage of assets this year.

Senator CURTIS. May I ask you right there, do you have any information on what portion of foundation income in the past has been attributed to capital gains?

Mr. GOHEEN. No, sir; we do not have that information.

Senator CURTIS. But it is a fact with every foundation, is it not?

Mr. GOHEEN. Well, not in every foundation because—

Senator CURTIS. Well, most of them where, if they have a diversified portfolio, the chances are they now and then choose to sell something because there is a substantial profit and reinvest in something that holds some promise, and they show capital gain.

Is that correct?

Mr. GOHEEN. That is correct.

Senator CURTIS. So the fact that in the dividends held up in many cases, it does not follow that income of the foundation is held up.

Is that not right?

Mr. GOHEEN. If you think of income as total return, sir; that is correct, absolutely.

Senator CURTIS. And if in order to meet the statutory requirements of payout, if that has to be met in part from corpus, it will take more shares with the depressed stock market than it would otherwise.

Is that right?

Mr. GOHEEN. Well, sir; as the asset values go down, the percentage requirement, or minimum investment return is 5.5 percent this year, of course becomes a smaller amount because it is a percentage of those asset values.

Now what you are finding in some cases—and I am sorry to say we cannot give you numbers as to what proportion of cases—is that, as asset values have gone down the minimum investment return has

gone down, but earnings, if the investments have been in high grade bonds and things of that sort are now higher than the minimum investment return, so that you have some of these foundations having now to meet the other requirement of the law, which is to pay out all net investment income every year.

Senator CURTIS. Well, I do not want to sidetrack you from your statement but I think it is a very important and valid point, in assuming that if a foundation had a major portion of their assets invested in equity stocks and they had to reach into corpus to meet the mandatory payout, regardless of what it was, that they are going to have to sell many more shares than they would have.

Mr. GOHEEN. Absolutely; yes, sir.

Senator CURTIS. Before the stock market decline——

Mr. GOHEEN. They have to sell at a very disadvantageous time, that is correct.

Senator CURTIS. You may proceed.

Mr. GOHEEN. I shall be coming back on the payout question in just a moment.

I was pointing out that in the experience of a number of foundations besides the Ford Foundation, with the plummeting in asset values, distribution levels that they had planned of let's say 6 percent or 8 percent have become 10, 12, and 14 percent against the new asset values. It takes little foresight to see that you cannot spend at those levels and maintain the effective capacity of the foundation very long.

In summary, then, on the economic conditions, they are having varied consequences for foundations. They are imposing some very difficult choices. They are likely to pose even more difficult choices in the future.

To be noted is the double-bind in which many foundations find themselves between significantly reduced asset values on the one hand and, on the other hand, the effects of rampant inflation on the services and institutions with which foundations normally work. In other words, shrinking dollar holdings are confronting mounting dollar needs.

I would point out that the funding problems of the whole non-profit, charitable service sector, including the foundations, relate inexorably to the problems of the economy as a whole. The economic problems of the philanthropic, charitable sector are fundamentally going to be resolved only as the economy's general problems of inflation and recession are corrected. Yet, the circumstances I have just outlined, do, I submit, make timely a fresh examination by Congress of three other sets of requirements placed on the foundations by the 1969 act.

The first of those limits is the 4 percent excise tax imposed on the net investment income of private foundations. Almost infinitesimal in relation to the Federal budget, these dollars taken into the general revenue by the tax could have made a real difference to many of the charitable organizations for which they otherwise would have had to be available.

In October, this subcommittee issued an admirable statement outlining the legislative history of the 4-percent tax and recommending

its reduction to 2 percent. We strongly favor that change in public policy because it will help the foundations to better help those with whom they work.

Second, I wish to submit that the down-slide of equity values since 1968 and 1969 and especially the sharp decline of the past year raise serious doubts about some of the assumptions on the basis of which the current minimum investment return requirement was legislated in 1969. There are really two sets of problems here.

First, as the subcommittee's own statement of October 4, 1974 recognizes, the method for setting and adjusting the MIR fails adequately "to take into account the equity side of foundation investment policy," and apparently Treasury's interpretation of the statutory language has been to emphasize money rates represented in 5-year maturity Treasury bonds. We would favor, as the subcommittee's statement does, the use of a composite of indicators and suggest in addition that these should include the total return performance of equity holdings. A further difficulty is that the present formula involves considerable volatility, because it depends on very short timeframes—the current year compared to 1969. Averaging over longer periods would bring more stable results and permit better planning.

But beyond those considerations is the matter of the height of the norm. By whatever indicators the annual requirement is set, 6 percent of assets is an excessively high measuring stick.

You will recall that in 1969 the Treasury, the Senate Finance Committee, and the House Ways and Means Committee all recommended a 5-percent norm, a figure that I personally would regard to be fairly reasonable, but that figure was raised on the floor of the Senate to 6 percent on the basis of the high total returns produced by mutual funds during the 1950's and early 1960's. There is now good evidence, reinforced by the record of the past 5 years, that over long periods of time well-managed funds invested broadly in American capital markets have yielded  $4\frac{1}{2}$  to 5 percent in real returns, not the 6 percent and upward which experience drawn only from the 1950's and early 1960's seemed to make predictable.

Now to ask for a more realistic adjustment of the MIR, on the basis of the long-term real experience of invested funds, is not to argue that any foundation should be allowed to pile up income or otherwise act cavalierly toward the current pressing needs of the educational and other charities.

We have previously stated to this subcommittee our strong support for the requirement of a substantial annual payout, and I reemphasize that support today. I submit, however, that an MIR in the  $4\frac{1}{2}$  to 5 percent range would meet that test of substantiality and would also be consonant with the long-term real experience of invested funds. Moreover, the fact that foundations must expend annually all of their net investment income, where that exceeds the MIR, provides a further salutary check against any excessive accumulation of foundation dollars to the neglect of current needs.

Third, a progressive forced diminution in the capability of existing foundations is, we believe in no one's interest, unless perhaps substantial offsetting infusions of new funds were to be occurring. Probably it

would not be in the general interest even then, but if existing foundations are to be consigned to lessening roles, the capability for a continuing flow of new funds into the foundation field becomes an especially critical matter.

Unfortunately, it is difficult to get accurate measures of what the Tax Reform Act of 1969 has meant to the death- and birth-rates of foundations.

In a letter of October 2, to you, Senator Hartke, Commissioner Alexander reported that foundations established after the 1969 law went into effect represent holdings of \$977 million in terms of relatively current values.

Now I do not know whether the computer lost some digits off of one end or the other here too, but so far as we have been able to verify and cross-check that figure, it appears to represent much less in the way of new money available for charitable purposes than it would seem to on its face value.

For example, our investigations quite strongly suggest that that figure includes many pre-1969 grant-making organizations with nothing new about them except that they received the IRS exemption letter after the 1969 act took effect.

The most comprehensive collection of the available evidence on death and birth rate matters remains the testimony of Professor John Simon before this subcommittee on October 1, 1973, and you will remember that it led him to doubt that the private foundation species will be able to reproduce its kind at a level sufficient to offset the losses.

A more recent analysis of the creation and dissolution of private foundations in a 12-State area, a study conducted by the foundation center here in Washington, tends to confirm that judgment. It shows a very sharp drop in the number of new foundations created from 1968 to 1970, with some leveling off at the lower level after 1970. There was a similar sharp increase in the number of dissolutions in the period of 1969 to 1972, and although the rate of dissolutions was declining by 1972, the death-rate of foundations far exceeded the birth-rate.

Indeed, sir, if you see the phenomena in this study put on a graph, it is just like an x, with the creation of new foundations going down from 1969 and the number of foundations going out of business going up. The lines cross almost like a perfect x.

All of this leads us to urge a reexamination and correction of the several major statutory provisions that are discouraging the establishment of new foundations and the augmentation of existing ones. Of particular significance are the limits which the 1969 act imposes on the tax deductibility of gifts to private foundations as against gifts to public charities.

In conclusion, Mr. Chairman, let me say that we agree with you when you wrote that foundations are "an important alternative to government," and when you cited them as critical "expressions of voluntary effort" aimed to help meet "the many difficult social problems facing our nation."

It is in that perspective that we believe that their treatment as second- or third-class philanthropic citizens calls for reconsideration. This reconsideration is opportune just now not only because of the sharp erosion being experienced in existing foundation assets, but also because of the extent to which the hyperinflation is daily increasing

the financial needs of the many, varied private agencies and institutions with which foundations normally work. Clearly, their needs are for more, rather than less, of the kind of support that foundations have extended to them in the past.

Sir, that concludes the summary of my written statement. I would like to say next, if I might, that Mr. Vernon Jordan executive director of the Urban League cannot be here this afternoon. He was here this morning. He asked me to convey to you and to Senator Curtis his regret at not being able to stay to testify personally, and he asked me to submit to the committee for the record the written testimony which he has prepared.

Senator HARTKE. Yes, that certainly will be part of the record and will come after your presentation, not in the middle of it.

Let me ask you during the last 5 years, do you think that the investment of the foundations has been wise?

Mr. GOHEEN. Have the investments been wise?

Senator HARTKE. Yes.

Mr. GOHEEN. Well, I guess in hindsight those who had the most conservative investment policies at the moment feel themselves very wise indeed. But I would think that overall most foundations, like most other private endowments, have found that the future of the market is a very difficult thing to predict and many of them have taken quite a licking.

Senator HARTKE. Do you think that the 1969 act has had any effect which has forced or required or encouraged foundations to invest in securities, which have been especially sensitive to this economic downturn?

Mr. GOHEEN. Well, the 1969 act, including the minimum investment return, brought in an assumption that a foundation, or at least strongly suggested that a foundation, normally should be required to pay out something more than its earnings just from dividends and interest. In other words, some of the annual capital appreciation was regarded a proper annual expenditure, a contribution to current charity. I think that did help to bring about a greater movement toward broadly diversified portfolios with heavy equity components. But there were other things in the investment climate that were pointing that same way at that time.

Senator HARTKE. Well, you said in your statement now, for example, that most of the losses so far in these investment portfolios have been paper losses.

Mr. GOHEEN. So far; yes, sir.

Senator HARTKE. And that the earnings on income has remained pretty well up.

Mr. GOHEEN. Earnings considered as yields on equities and on bonds.

Senator HARTKE. Why has it been especially hard to keep up the 6 percent pay-out if that is the case?

Mr. GOHEEN. You can pay 6 percent and more when your stocks are appreciating and you have some gain there to expend. But when your stocks are depreciating as rapidly as some of them have, you are forcing, as Senator Curtis was pointing out to me a little bit earlier, you are forcing foundations to get rid of equity holdings at a very disadvantageous time in the market to meet these obligations.

Senator HARTKE. Has it had that much effect?

Mr. GOHEEN. I think it certainly has had in some cases. We are, again, in an area where it is very difficult to have all of the information that one would like, but I have reported some examples for you in my written testimony.

Senator HARTKE. You had this example of the survey, the study you did, of 30 foundations.

Is that correct?

Mr. GOHEEN. Yes, sir.

Senator HARTKE. Do you think that survey is representative of the foundations, generally speaking?

Mr. GOHEEN. We think it is representative of medium-size and large foundations.

Senator HARTKE. That is what I was going to say.

Mr. GOHEEN. Yes; and it is partly representative because if you look at it there is a great deal of variety in it. As I also cite in my testimony, the economic downturn has had varied consequences for different foundations. If you get a 26-percent decline overall—I do not have the figures right at hand but if there were 26-percent overall decline—for some it is not more than 12 percent, for others it is a lot more than 26 percent. That is an overall figure.

Senator HARTKE. Do you have any idea what the Treasury Department will establish as the minimum requirements for their distribution level next year?

Mr. GOHEEN. Well, we had strong suspicions of a possibly very high requirement which were confirmed by the letter addressed to you from Mr. Hickman which I just was shown this morning. Using the formula in the way that Treasury has been using it, the 1975 requirement is likely to be over 7 percent. That would be very severe indeed on foundation holdings.

Senator HARTKE. Do you have any recommendations or any information that would be helpful to the subcommittee on how you would change the minimum distribution rule in the code?

Mr. GOHEEN. I think there are two ways that one could do it. One way would be to take the long-term real experience of funds broadly invested in American capital markets and say that through good times and bad that that guideline should prevail. That long-term experience is in the 4½- to 5-percent range. That would be one way to do it. In bad times it would mean losses for foundations, but in good times assets would build up to compensate. Here I am talking about long-term experience over 60, 70 or more years. Mr. Roger Kennedy, who will be appearing before you shortly, can speak more knowledgeably and in more detail about these matters if you wish.

The second way to do it would be to take the notion of a formula, and, as your own statement of October 24 indicated, make it a broader composite of different ingredients. It should include, we would urge, total returns as well as yields and long term bonds as well as 5-year treasuries, and should relate them to longer timeframes. The example your statement cites from the pension bill involves 10-year periods. In the current formula for foundations it is only two selected years, 1969 as against the current year, and that gives you very volative effects.

So, those would be ways in which the MIR could properly be adjusted, we believe, sir.

Senator HARTKE. In your testimony you said you believed that the IRS figure, which represents the asset value of foundations formed since the 1969 act, actually included some pre-1969 Tax Reform Act organizations which merely received their exemption after the act took place.

Do you have any information or would you supply us with information so that we can really check to see whether or not the IRS figures are correct or whether your assumption is correct?

Mr. GOHEEN. Yes, we have a small sample that we can share with you.\* In addition, Mr. David Freeman, who is scheduled to testify tomorrow, will be talking more about this subject.

Senator HARTKE. All right. Are you telling me that you think foundations are a dying institution?

Mr. GOHEEN. Well, I think that they are not a growing institution: They are not growing proportionately to the tremendous needs of this country.

Senator CURTIS. Will you yield right there? I do not know whether they are dying or not, but none of them are being born, are they?

Mr. GOHEEN. Very few are being born.

Senator CURTIS. Do you know of any foundations of any real significance that have been created since 1969?

Mr. GOHEEN. There are several, as indicated in the Treasury statement, some of which, quite clearly, go back to bequests that were written before 1969. The Geraldine Dodge Foundation, which got a lot of publicity a year or so ago, is reported by the press to be worth about \$80 million. But it comes from a bequest written before 1969 and the testator has also been declared non compos by the courts before that time.

Thus there are a few cases, sir, but I would say not many.

Senator CURTIS. It has not been nearly up to their normal growth, has it?

Mr. GOHEEN. It has not. I wish I had the chart with me covering the 12-State area foundation study to which I referred earlier. If you look at this 12-State area and take that as representative, the number of new foundations being created annually from 1969 on just plummeted downward and the number going out of existence goes the other way.

Senator CURTIS. Well, when individuals wish to give something away for a good cause, the logical thing is for them to give away that which they have, which is stock in their own company. And that is frowned on in the 1969 act with all of the emphasis on a diversified portfolio. And there are many features of the 1969 act that have definitely curtailed the foundation movement.

Mr. GOHEEN. Yes; that is right.

Senator HARTKE. What evidence is there that that is true? In other words, what evidence is there that it is as a result of the law?

Mr. GOHEEN. Well, you have got the numerical evidence that Professor Simon put together for you and this other evidence here.

Senator HARTKE. In other words, what you have there is the numerical evidence but that is not identified as to cause. What you are dealing with there are results.

\*See p. 90.

Mr. GOHEEN. You also have the evidence that you get from talking with law firms about how they are advising their clients and so on, and you find that most of them—

Senator HARTKE. They are advising them not to create them, right?

Mr. GOHEEN. Yes.

Senator HARTKE. On the basis of the law?

Mr. GOHEEN. Yes; usually not to create them.

Senator HARTKE. Pardon me?

Mr. GOHEEN. On the basis of the various complications or disincentives in the current law.

Senator HARTKE. Now wait a minute. I want to identify this. In other words, I am not saying the culprit is not the 1969 act, but I am asking, and I think it is open to serious question, whether that is the cause of it.

The fact of it is since 1969 the economic conditions in this country have had a steady downturn. You cannot say that the fact that that average wage earner has had a steady decrease in his income since 1969 was caused by the fact that we passed a law on foundations. You cannot say if there had not been a new issue on Wall Street in the last 2 years, that that is a result of the 1969 act. You cannot say that the present inflationary spiral is due to the 1969 act. You cannot say, for example, that the present increase in unemployment is due to the 1969 act.

Senator CURTIS. Oh, yes, I can. The 1969 act included a lot of things besides foundations. It set the ceiling for a good portion of the economic trouble that we have right now. It was a bad act, the whole thing.

Senator HARTKE. Well, like what?

Senator CURTIS. Well, we will debate that sometime when we do not have all these fine witnesses waiting to enlighten us.

Mr. GOHEEN. Mr. Chairman, may I—

Senator HARTKE. What I am saying to you is that I think what we are operating here is an area in which I have a very definite view of the fine work that has been done, but as Dr. Goheen knows, I want to know how taxpayers' money is being utilized.

Let me ask you—do you know how much is the annual revenue loss to the Government as a result of foundations?

Mr. GOHEEN. No. You have asked me that question before.

Senator HARTKE. I know it.

Mr. GOHEEN. In October of 1973.

Senator HARTKE. I still think it is a good question.

Mr. GOHEEN. My observation is that many people who have tried to work it out, including the people in Treasury, have not been able to do it.

Senator HARTKE. Do you not think that in itself is very significant, that you have an outflow of money from the Federal Treasury and we are not able to identify how much it is?

Mr. GOHEEN. Sir, as you know very well, I do not regard it as an outflow of money from the Federal Treasury; I regard it as money which the Congress, in its wisdom, decided not to take away from the people, considered as individuals and in voluntary associations, but left in their hands to administer and run under nongovernmental auspices.

Senator HARTKE. Wait a minute. Let me explain something first lest I be misinterpreted.



If there were no exceptions, if there were no subsidies, no tax avoidance, then there would be a different amount of revenue coming into Uncle Sam's Treasury. Now that does not mean that I am opposed to those operations. Frankly, I am probably one individual who is not opposed to subsidy, as much as some people, even though I know politically it is not good to be for a subsidy. But the fact that there is a subsidy for a purpose which, in the judgment of the people is needed, then I think we should do it.

But I do think that it is imperative that we come forward with some type of clear-cut understanding, not alone in the field of foundations but probably more so in the field of other charitable organizations of what the actual revenue loss is. And any good tax man will tell you it is a revenue loss. It is a revenue loss that may be a revenue loss for a very salutary purpose, which you may be able to say in the long run provides a benefit back to the people. That may be true, but that is not what has been the common terminology of revenue loss, or what a tax accountant would tell you is a revenue loss.

They will tell you also, and I will tell you quite honestly that a tax deferral is also a revenue loss. We can argue all we want to that a tax deferral is a revenue loss. It may be recouped at a later time partially, but it still is a revenue loss at that particular time.

Now, what I am saying to you is, that I do think somebody, and after all, you are chairman of the Council on Foundations, that I think some place along the line it is imperative that you insist that the Treasury come forward, and as I will insist, and make the best determination as to what the facts are as to the revenue lost.

Do you know what the stated assets of the foundations are?

Mr. GOHEEN. We know better than the IRS.

Senator HARTKE. I would not be a bit surprised about that. I think that might be true.

Mr. GOHEEN. We know that 24,000 foundations whose IRS records are with the Foundation Center, in 1972, had total assets of \$31.5 billion.

Senator HARTKE. How much?

Mr. GOHEEN. \$31.5 billion. At that point in 1972. They are probably considerably less than that now.

Senator HARTKE. I would think that is a fair interpretation.

Mr. GOHEEN. It is in that order of magnitude.

Senator HARTKE. But that lessening of the asset valuations is due to economic conditions?

Mr. GOHEEN. Yes, sir, I agree with that; that is what I was testifying about.

Senator HARTKE. I understand that.

Mr. GOHEEN. Could I go back on the earlier point, to the things you quite rightly said were not a result of the 1969 act? I think that none of those things bears on foundations very much.

What you have in the case of foundations is that before 1969 under certain tax laws, many foundations were being created: that is well known and documented. Since 1969, many fewer have been created. When you ask people why that is—people who advise the people in position to set up foundations or donors who potentially might set up foundations—you find that they are troubled that if they do this in their lifetime, they cannot give away as much as if they gave it to a

public charity. They find that they would have to pay a tax on the appreciation of their holdings. They find that if they gave to a foundation stock in a family-held company, in 5 years it would have to be diversified and spread out. I think those are the main discouragements. Moreover, there is no carryover on these gifts.

Senator HARTKE. Well, let me say to you, though, Dr. Goheen, it may be true, that foundations may not be the best utilization of that \$31.5 billion from a viewpoint of an individual if he is going to make decisions regulating the use of his money. It may be true that a charitable organization at this time still provides for the type of windfall operation which ought to be closed.

Now the fact is that we have closed some of those windfall operations. We may have deterred some individuals from setting up new foundations because the tax avoidance game is no longer available to them. That is like saying, for example, that the Ways and Means Committee has decided to eliminate depletion, that may just discourage some people from going into the oil business, but it may not be a bad thing simply because it does.

Mr. GOHEEN. Well, as I have said to you before in this room, there clearly were, before 1969, certain inappropriate uses of the tax privilege associated with foundations. Those were properly closed off in the 1969 law. I am not speaking against that at all. I am speaking rather about the experiences of what seem to us to be very responsible, publicly-concerned people.

One of the interesting pieces of missing information that, let us hope, under your prodding IRS will be able to give us 1 year and 2 years hence is whether more money has really flowed to the public charities because of the tightening up on giving to private foundations. Right now from the available data, you cannot answer that question. There is some evidence, fragmentary, that there has not been an appreciable shift at all.

Senator HARTKE. All it serves to do is to point out how far we are from really knowing what we are doing.

Mr. GOHEEN. Yes, sir.

Senator HARTKE. Let me say to you, I would hope in your responsible position that you would continue to make the efforts inside your own organizations and work with us and with the Treasury Department and the IRS to come forward with some of this factual information so that we can continue this pluralistic approach in a fashion which can be demonstrated to be useful, on the basis of facts other than rhetoric.

Mr. GOHEEN. I find the most frustrating thing about this whole business, Senator, is the lack of really hard information bearing on some of these important policy questions. I have spoken to you about that before, and I certainly think the kind of pressure this subcommittee is now putting on the IRS has already started to give us hope for the future.

Senator HARTKE. All right.

I have no further questions.

Senator CURTIS?

Senator CURTIS. I have no questions.

Senator HARTKE. Thank you, Dr. Goheen.

[The prepared statements of Messrs. Goheen and Jordan and information subsequently supplied by Mr. Goheen follow:]

PREPARED TESTIMONY OF ROBERT F. GOHEEN, CHAIRMAN, COUNCIL ON FOUNDATIONS

I. INTRODUCTION

Mr. Chairman, members of the Committee, my name is Robert F. Goheen and I represent the Council on Foundations, a membership organization of some 735 grant-making foundations, small and large, located in all parts of this country.

I welcome very much the opportunity to appear before the Subcommittee to comment on the impact of the current economic situation on foundations and foundation beneficiaries and to speak to some of the policy issues that are high-lighted by the current state of these affairs.

There is a good deal of ground which I would like to cover. I shall speak at points in rather categorical or summary terms because others will be elaborating those points and offering additional evidence in the course of these two days.

II. ECONOMIC EFFECTS

With the steeper down-turn of the stock market over the past 12 months or so, many foundation portfolios, including many that are broadly diversified, have declined sharply in value. An instance that has drawn particular press attention because of its very size is the Ford Foundation, which experienced a decline in asset value from about \$3 billion to about \$2 billion in the year ending October 15, 1974. Some \$700,000,000 of that decline was due to the market drop. Such, however, is not the Ford Foundation's experience alone.

A recent sample survey conducted by the Council on Foundations, involving 18 of the largest and 12 middle-sized foundations, showed them to have had \$10.87 billion in assets at the end of 1973. Eight and nine months later, the figure was \$8.04 billion. This \$2.8 billion drop, incidentally, is somewhat more than all estimated foundation giving for all purposes in 1972-73, which was \$2.38 billion. The average decline for these foundations was 26.07% of assets. Of the 30 foundations in the sample, a few had done considerably better than that; some had fared far worse.

Fortunately, most of these are "paper losses". Earnings on investments have by and large held up well, even while earlier expectations of capital appreciation have turned to ashes. Thus a comparison of adjusted net income figures for 1973 and those estimated and available for 1974, involving 16 of the large foundations are seeking to maintain past levels of giving and even to increase them of 3.95%, or an increase of \$12 million for an estimated total of \$318 million. Income of only three of these 21 foundations appears likely to be lower in 1974 than 1973.

Buoyed by relatively good continuing yields in the form of dividends and interest and responding to the critical need of grantee organizations, for most of which the effects of the current hyper-inflation are very acute, some foundations are seeking to maintain past levels of giving and even to increase them despite the market decline. Some foundations are sustained in so doing because they are now finding that the required pay-out as a percent of assets (5.5% for accounting years beginning 1974) is being exceeded by their dividend and interest income. As you are aware, the law requires that the greater of these two amounts must be distributed.

In other cases, to offset the shrinkage of assets and to preserve for the future so much of their support power as is allowable, foundations are planning to expend no more than the law requires in the remainder of this year and in 1975. This will represent in many of these cases substantially lower levels of grant-making than had been planned, or than would have been thought to be required, a year ago when the asset values of these foundations were a good deal higher.

The problem is particularly difficult for foundations which have in the past regularly made contributions considerably exceeding the legal requirement. The Ford Foundation is again the salient, but not the sole, example. You will, I think, be hearing about its experience in some detail from Messrs. Howe and Kennedy in the course of these hearings, and so I shall not dwell on it.

In better economic times, when you can expect equity assets to appreciate, you can face with equanimity a pay-out somewhat above the yield you are getting from dividends and interest. The Minimum Investment Return requirement of the 1969 Act, of course, is pegged on that assumption. When, however, asset values plummet as they have, what was, say, a distribution last year of 8% of assets can become a 12% to 14% distribution or even higher percentage this year. Such in fact has been the experience of a number of other foundations besides the Ford Foundation, and it takes little foresight to see that if they were to continue to maintain these expenditure levels, their effective capacity would soon be greatly reduced.

Faced with this situation, foundation trustees are having to decide between a number of alternatives, none of them particularly pleasant:

Whether to cut back significantly on past levels of giving. If so, to what levels? to the minimum which the law allows? or where?

Whether to maintain something like their past giving levels, even where greater than the legal requirement, and hope that the market will ball them out in a not-too-distant future.

Or whether deliberately to undertake progressive liquidation of the foundation by a spending program that continues to be well in excess of foreseeable income and capital gains.

In summary, the current economic conditions are having varied consequences for foundations; they are posing some very difficult choices; and they are likely to pose more. Particularly to be noted is the double bind in which many foundations now find themselves between significantly reduced asset values on the one hand and, on the other, the effects of rampant inflation on the services and institutions with which foundations normally work. Shrinking dollar holdings confront mounting dollar needs. Even where foundation income has held up well, future prospects are not reassuring. Typically during a recession earnings of companies fall off and dividends decline. Nor does the reduction of inflation to a point where gains in productivity are able to approximate cost increases seem to be anywhere near at hand.

These circumstances make timely, I submit, a fresh examination by Congress of three of the sets of limits that were imposed on the private foundations in the 1969 Tax Reform Act.

### III. THE 4% EXCISE TAX

The first of these is the 4% excise tax imposed on the net investment income of the private foundations. At a time when growing human needs and hyperinflation are combining to strain to the limit the institutions and services which foundations normally support, the aid which foundations might be extending to them is being further reduced by this tax. Last year the tax collected over \$30 million above what the IRS needed to audit and supervise all tax exempt organizations. Almost infinitesimal in relation to the federal budget, these dollars could have made a real difference to many of the charitable organizations for which they otherwise would have had to be available.

On October 4, 1974 this Subcommittee issued an admirable Statement outlining the legislative history of this tax and recommending its reduction to 2%. We strongly favor that change in public policy because it will help the foundations to better help those with whom they work.

### IV. THE 6% MINIMUM INVESTMENT RETURN

Secondly, I wish to submit that the down-slide of equity values since 1968 and 1969, and especially the sharp decline of the past year, raise serious doubts about some of the assumptions on the basis of which the current minimum investment return (MIR) requirement was legislated in 1969. There are really two sets of problems here.

First, as the Subcommittee's own Statement of 4 October 1974 recognizes, the method for setting and adjusting the MIR fails adequately "to take into account the equity side of foundation investment policy," and apparently Treasury's interpretation of the statutory language has been to emphasize money rates represented in 5-year maturity Treasury bonds. We would favor, as the Subcommittee's Statement does, the use of a composite of indicators and suggest in addition that these should include the total return performance of equity holdings. A further difficulty is that the present formula involves very short

time-frames—the current year compared to 1969. Because capital markets are very volatile, there is thus considerable instability built into it. This plus a heavy reliance on money rates could in combination give us an MIR rate as high as 7% or 7½% in 1975—a level that I believe anyone would agree to be much too high, except those who do seek the dissolution of foundations. Messrs. Jacquette of the Carnegie Corporation and Huffaker representing the Pew Memorial Trusts are, I believe, prepared to speak in more detail about this problem.

The second difficulty lies in the height of the norm set by the statute for the MIR. By whatever method the annual requirement is set, 6% of assets is an excessively high measuring stick. Because the Subcommittee has earlier received considerable testimony on this problem and others will be addressing themselves to it further today or tomorrow, I shall again be very summary here.

You will recall that in 1969 the Treasury, the Senate Finance Committee, and the Ways and Means Committee all recommended a 5% norm, but this was raised on the floor of the Senate to 6% on the basis of the high total returns produced by mutual funds during the 1950's and early 1960's. There is now good evidence, reinforced by the record of the past 5 years, that over long periods of time well-managed funds invested broadly in American capital markets have yielded 4½ to 5% in real returns, not the 6% and upwards which experience drawn only from the 1950's and early 1960's seemed to make predictable. What this means is that this year and henceforth a progressive annual deterioration of the support-power of existing foundations is embodied in the current MIR, with its requirement of a 5.5% pay-out this year and the possibility of that rising well over 6% in 1975.

To ask for a more realistic adjustment of the MIR, based on long-term real experience with invested funds, is not to argue that any foundation should be allowed to pile up income or otherwise act cavalierly toward the current pressing needs of the educational and other charities. The Council on Foundations has previously stated to this Subcommittee our strong support for the requirement of a substantial annual pay-out, and I re-emphasize that again today. I submit, however, that a MIR that operated in the 4½ to 5% range would meet that test, as well as being consonant with the long-term real experience of invested funds. Moreover, the requirement on foundations to expend annually all net investment income, where that exceeds the MIR, provides a further check against any excessive accumulation of foundation dollars to the neglect of current needs. And that is certainly a feature of the law that should be retained.

#### V. THE BIRTH/DEATH RATE PROBLEM

A progressive, forced diminution in the capability of existing foundations, in my belief, is in no one's interest, unless perhaps substantial offsetting infusions of new funds were to occur. Probably it would not be in the general interest even then, but if existing foundations are to be consigned to lessening roles, the capability for a continuing flow of new funds into the foundation field becomes an especially critical matter.

Unfortunately it appears to be very difficult to get accurate and comprehensive measures of what the Tax Reform Act of 1969 has meant to the birth- and death-rates of foundations.

In a letter of October 2, 1974 to Senator Hartke, Commissioner Alexander reported that foundations established since the 1969 law went into effect represent holdings of \$977 million in relatively current values. However so far as we are able to verify or cross-check that figure, we do not believe that it represents as much in the way of new money available for charitable giving as it might seem to. For example, our research quite strongly indicates that the IRS figure includes many pre-1969 Tax Reform Act grant-making organizations with nothing new about them except that they received an IRS exemption letter after the Act took effect.

The most comprehensive collection of the available evidence on the death/birth rate question remains the testimony of Professor John Simon before this Subcommittee on October 1, 1973, and you will remember that it led him to doubt that the private foundation species will be able to reproduce its kind at a level sufficient to offset its losses.

A more recent analysis of the creations and dissolutions of private foundations in a twelve-state area conducted by The Foundation Center in Washington shows that a very sharp drop occurred in the number of new foundations created from

1968 to 1970, with leveling off at the new lower level after 1970. There was a similar sharp increase in the number of dissolutions in the period 1969 to 1972, and although dissolutions were declining by 1972, the "death-rate" of foundations far exceeded the "birth-rate". (These trends are in sharp contrast to the situation prior to 1969. In the 12-state area examined by The Foundation Center, 1,228 foundations were established in 1968 as opposed to 71 terminations. In 1972, 128 foundations were established, while 605 foundations were terminated.)

All of this leads us to urge re-examination and correction of the several major statutory provisions that are discouraging the establishment of new foundations and the augmentation of existing ones. Of particular significance here are the limits which the 1969 Act imposes on the tax deductibility of gifts to private foundations—and especially with respect to gifts of appreciated securities—as against gifts to public charities. But these are matters on which other witnesses, including the President of the Council on Foundations, will be testifying more fully at other points in this hearing, and therefore I shall not dwell on them further here.

#### VI. CONCLUSION

In conclusion, let me say, that we agree with the Chairman of this Subcommittee when he wrote that foundations are "an important alternative to government", and when he cited them as critical "expressions of voluntary effort" aimed to help meet "the many difficult social problems facing our nation". It is in that perspective that we believe that their treatment as second- or third-class philanthropic citizens calls for reconsideration. This reconsideration is opportune just now not only because of the sharp erosion being experienced in existing foundation assets, but also because of the extent to which double-digit inflation is daily increasing the financial needs of the many, varied private agencies and institutions with which foundations normally work. Clearly their needs are for more, rather than less, of the kind of support that foundations have extended to them in the past.

#### PREPARED TESTIMONY OF VERNON E. JORDAN, JR., EXECUTIVE DIRECTOR, NATIONAL URBAN LEAGUE, INC.

Mr. Chairman and members of this subcommittee, I am Vernon E. Jordan, Jr., Executive Director of the National Urban League, Inc. I am pleased to be here today in response to Senator Hartke's invitation to share with you the views of the League as a recipient of many foundation grants over the years on the impact of the prevailing and forecasted economic conditions in this country.

The National Urban League is a non-profit, non-partisan charitable and educational organization which was founded in 1910 to secure equal opportunities for black Americans and other disadvantaged minorities. It is governed by an interracial board of trustees, and it seeks to improve race relations among all people of the United States.

Among the League's pursuits are programs to enhance equality of employment and housing opportunities, to provide alternatives to traditional educational methods which have failed minority youth, to develop and strengthen family life, to encourage active and responsible citizenship by minorities, and to assist individuals in solving their problems in the areas of employment, education, health, and economic development. The League also acts as an advocate to present the minority point of view on matters of concern to its constituency.

Operating through its 103 local affiliates in 36 states and the District of Columbia, the League maintains a national headquarters in New York City with regional offices in Akron, Atlanta, New York, Saint Louis, and Los Angeles. A Washington Bureau and a Research Department are located here in the nation's capital. The National Urban League and its affiliates have a combined staff of more than 2,500 assisted by approximately 20,000 volunteers who bring expertise and experience to the resolution of the problems facing minorities.

My comments today will be in the context of the fund raising effort required to support the activities of the National Urban League itself rather than to include the variety of situations facing each of our local affiliates. To a greater or lesser degree, I am sure that my comments apply to our local affiliates as well if for no other reason than some of the funds raised by the National Urban League directly benefit the affiliates.

During the last three fiscal years, the funds raised by the League from private sources have included a high percentage from various foundations. The percentage from foundations has ranged from approximately 30% to approximately 43% of the private funds raised. Some of the foundation funds have been earmarked for specific uses, but the trend over the last several years has been an increase in the percentage of foundation funds which can be used for the support of the League's general operations. During the last three fiscal years, the League has received over six million dollars in grants from various foundations. Suffice it to say, the League is heavily dependent upon foundation grants for the continuation of its operations.

The League, unlike most of its sources of private funds such as corporations and foundations, has no reserve of assets upon which it can draw in times of adversity. It is wholly dependent upon current income to continue its operations. An interruption of that income not only causes an immediate cessation of some portion of the League's operations, but it has an impact that can linger for years in the future because valued staff members and program momentum are lost.

Most of the foundations from which the League derives support in the form of grants rely on their income from investments rather than an invasion of the foundation corpus to meet its commitments. In a sense, this is double jeopardy of a sort for the League because other types of fund sources such as corporations rely on the same capital investment base as do the foundations. A slackening of income to the foundations translates rapidly into a decline in the level of grants to the League while alternative sources of funds dry up simultaneously. Of course, many foundations could invade corpus to continue making grants, but that isn't a practical alternative in today's investment market because the corpus has already been drastically reduced by deflating investment market values. Even if lowered investment values were not as great a consideration as they must be today, the habitual invasion of corpus would result in a borrowing from future needs which do not appear to be declining.

Except for such foundations such as Ford which have regularly invaded corpus in the recent past, most foundations have been able to maintain the current dollar level of their income and grants. That has meant that the League has been fortunate enough to maintain its income. The impact of inflation, however, makes maintenance of income an illusory comfort. The costs of operation have risen sharply over the past several years, and I suppose that they will continue to do so for the next several years. The League has managed to hold the line on its general budget, but that has meant that the real purchasing power of that budget has declined at an ever increasing rate. During the last fiscal year and during this fiscal year we have had to allow some rises in budgetary level just to maintain our effectiveness. The most unfortunate aspect of this is that times of economic adversity such as we are experiencing now creates a higher demand for the kinds of services that the League provides.

I hope that my outline of the League's situation has been sufficient to suggest that the government should adopt a flexible policy with regard to the financial aspects of private initiative to solve the pressing problems of our society. You must not wait until the crunch of declining foundation and corporate income is upon us. It will be too late to prevent curtailment and disruption of the services rendered by private organizations such as the League.

One of the most obvious measures to mitigate the impact of continuing inflation and possible diminution of income that this subcommittee could recommend to Congress is the reduction of the current 4% excise tax imposed upon the foundations. It is my understanding that a reduction in that tax rate to 2% would result in an increase of about \$35 million available for grants. Such a reduction, I am informed, would still generate more than enough revenue to fund the legitimate audit operations of the Internal Revenue Service. This single reform would go a long way to mitigate the impact of inflation on the flow of grants from foundations. There is an immediate and pressing need for such relief because other sources of income to the League are not likely to increase their donations by an amount sufficient to offset the increase in inflationary costs.

Racial minorities bear a disproportionate amount of the burden of our times. I am sure that the unemployment rate for blacks and other minorities will be no less than 11.5% when this month's statistics are released. We must all constantly strive to remove this sort of inequity from our society. We need relief now, before the dominoes fall to stifle our resources when we need them most.

Thank you, Mr. Chairman, for having solicited the views of the National Urban League. I will be happy to answer any questions that you or your colleagues may have.

COUNCIL ON FOUNDATIONS, INC.,  
New York, N.Y., January 20, 1975.

HON. VANCE HARTKE,  
313 Senate Office Building,  
Washington, D.C.

DEAR SENATOR HARTKE: During Mr. Goheen's recent testimony before the subcommittee on Foundations, he agreed to have the Council supply a small sample of information that might help analyze I.R.S. figures for current assets of new foundations formed since the Tax Reform Act of 1969, as to whether their figures include foundations established before the Act took effect.

As stated in the testimony of David F. Freeman, President of the Council on Foundations, The Foundation Center has identified only about 50 organizations qualifying for the size limitations of The Foundation Directory, Edition 5 (\$1 million or more in assets and annual expenditures of \$500,000 or more) with possible post TRA creation dates. Total assets for this group were about \$180 million.

However, a spot check of a few of the organizations in this group produced information suggesting that a majority of new organizations in the Center's list may have been established under pre-1969 TRA trusts and wills. The two specific examples cited in Mr. Freeman's written testimony where we were advised organizations had filed returns with state offices for years prior to 1969 are the Josephine G. Russell Trust and the George and Beatrice Sherman Family Charitable Trust, both of Massachusetts.

It should be noted we cannot be certain these organizations or others identified by the Center are included in the I.R.S. asset figure of \$977 million for post-Act foundations. The I.R.S. data provided only a cumulative asset figure, and the number of organizations involved, their names, and their status as operating or non-operating foundations were not available to us.

Sincerely,

EDWARD G. THOMSON,  
Executive Associate.

Senator HARTKE. The next witnesses are Roger Kennedy and Harold Howe. These gentlemen are from the Ford Foundation.

Harold Howe is placed in the position of defending not alone the foundations, but defending the sharp criticism Dr. Knowles had about the decline in the quality of education in the United States. How about that, as a former educator?

Mr. HOWE. I look forward to it.

Senator HARTKE. Well, let us proceed.

**STATEMENTS OF ROGER G. KENNEDY, VICE PRESIDENT FOR FINANCIAL AFFAIRS, FORD FOUNDATION; AND HAROLD HOWE II, VICE PRESIDENT, DIVISION OF EDUCATION, FORD FOUNDATION**

**STATEMENT OF ROGER G. KENNEDY**

Mr. KENNEDY. My name is Roger Kennedy. We filed testimony earlier which we hope we could submit for the record. In the interests of time I thought all I would do is say very quickly that Ford Foundation expended for program purposes about \$250 million in this last year, about 14 percent of its assets, which comes at the end of the decade in which its average annual expenditures have been 8½ percent of its assets. Within the context of very adverse capital markets, if you



add 14-percent payout to 12-percent inflation, you have a pretty sick situation.

We share the views of a number of other people who have testified here this morning and this noon. We also feel that the beneficiaries of charity should be given, a good deal of the tax money that now is supposed to go for auditing foundations, so we favor a reduction of the excise tax. We also favor strongly a reappraisal of the payout provisions for the reasons that have been suggested here earlier, and we do think there are some deterrents in the act for the formation of new foundations, though we also find it difficult to get hard data about foundation "starts."

Senator HARTKE. Mr. Howe?

#### STATEMENT OF HAROLD HOWE II

Mr. HOWE. Mr. Chairman; I, too, would like to submit my formal testimony for printing in the record and just make one or two observations from it, if I may. It is entirely on the subject of the effects of the current economic situation of foundations on their grantees. I am not an economic or fiscal expert, and I will turn your questions of that nature to Mr. Kennedy.

In addressing the question of the effects of the current economic situation on grantees, I found myself forced to look at the whole field of philanthropy, of which foundations are only a part, because hospitals and colleges and universities, which depend heavily upon philanthropy, depend not only upon foundations but upon individual donor and bequests and corporate giving. In looking at that broad arena, it became clear that foundations constitute only about 10 percent of the total philanthropic effort in the United States in any given year. So that the institutions that you and the rest of us are concerned about have to look at the total philanthropic world; and I would submit that the total philanthropic world is as heavily affected as is the foundation reaction of it by the combination of inflation and recession that we are experiencing. I submit also that the total decline of philanthropic resources for these needy institutions impacts them more heavily than other elements of the society are impacted by inflation and recession combined.

I think that the institutions served by philanthropy get hit three ways: They are hit first of all by the simple fact of inflation, which means that the dollars they get do not go as far; they are hit by the fact that their donors, the foundations and others, cannot give them as many dollars because their donors are not in as good condition as they were; and third, they are hit by the fact that most of these organizations that depend upon philanthropy are of a particular nature. They provide human services of one sort or another, education or health care or artistic performances. These kinds of endeavors are what the economists call "labor intensive." They are not subject to the application of labor saving machinery and capital investment to make major changes in efficiency. These labor intensive enterprises—hospitals, colleges, and symphony orchestras—suffer from inflation more seriously than those that can use labor saving investments to promote efficiency.

Now, with that as background, I explore in this testimony the special situation of private educational institutions in the United States, which I think is serious.

Private colleges and universities have only two sources of private income, the fees they charge their students, and the money they get from private philanthropy. If they push their fees to students too high, they price themselves out of the market. They are having a very difficult time getting the increase in donations from foundations or other sources of philanthropy that they need to preserve quality and that some of them need to survive. I happen to believe that this private sector of education is a significant sector, particularly in the higher education realm.

The argument is sometimes made that the private philanthropic sector is not very significant. Looking at this philanthropic sector, the best estimate I could come to was that it amounts to somewhere around \$25 billion a year, a great deal of money, that is distributed each year by individual donors, by bequests, some 10 percent of it by foundations, and about 3 percent of it by corporations. It adds up to a massive private system of human welfare in the United States, unique in this society. There is nothing like it anywhere else.

The massive private system of human welfare that parallels our much more massive public system is to be treasured. We would be much worse off were we without it, and ours is a less healthy society when it is unhealthy.

So it seems to me that we are wise to address ourselves, as we are in these hearings, to at least a segment of the private sector of philanthropy, and to ask questions about its health, the foundation sector.

Mr. Kennedy and I will try to answer your questions.

Senator HARTKE. The role of the private college, as you have indicated, has been a very profound one throughout the history of our country, I believe.

Are they destined to become extinct, I mean, except for Harvard and Yale?

Mr. HOWE. Mr. Chairman, my cloudy crystal ball on that subject is no better than anybody else's. They are certainly in serious trouble, and you and I read every month or so about the failure of another private educational institution.

I do not believe that the private philanthropic sector alone will be able to rescue these institutions. I believe that it will be a combined effort of new Government policy and the private philanthropic sector that will do the job.

I think, however, that the privacy of these institutions and their capacity to do the kinds of things they want to do, whether they seek a religious bent, as many of them do, or whether they seek a particular innovation that is not typical of public education, as some of them do, give them their distinctiveness. The private philanthropic sector will help them to preserve that distinctiveness which makes a special contribution to the quality of education in this country. I see great value in private higher education, and I think a combination of new Government policy and the help and health of the philanthropic sector is needed to preserve it.

Senator HARTKE. Do you know what the dollar value is of the contributions and the grants made to private colleges from foundations last year, for example?

Mr. HOWE. I do not have that figure with me, but I can get it for you, but I can tell you that in foundation giving generally education is the single largest category. If you take the three broad categories of education, welfare and health, they account for about 70 percent of foundation giving, and education is certainly the leader in attracting foundation dollars.

[The following material was subsequently supplied by Mr. Howe:]

During the school year 1972-73, the latest year for which figures are available, private foundations contributed approximately \$525 million for higher education; approximately 75% was for private institutions and 25% for public institutions.

Senator HARTKE. You know, if the programs which the Ford Foundation has supported over the last decade were really worthwhile—and I would assume that you would say they were—

Mr. HOWE. We certainly would agree.

Senator HARTKE. Are these programs that should be continued on a higher level?

Mr. HOWE. Are the programs that we now maintain programs that should be continued?

Senator HARTKE. The type of program that you have been supporting over the past decade, you said that those were worthy programs. What I am asking now is whether they should be continued at that same high level.

Mr. HOWE. Let me pick up some of your conversation this morning with John Knowles, president of the Rockefeller Foundation. When you and he were talking together about the importance of foundations looking toward the future, you certainly struck an important theme.

I do not think that any of us in the foundation business should argue that the programs that we happen to have supported for the last 5 or 10 years are better than those that other people may devise in the years ahead. So I would see changes in foundation programs occurring. But I think that if you are merely asking about the next 2 or 3 years—

Senator HARTKE. Let's take the next decade.

Do you feel that your participation in philanthropy should continue at about the same level? In other words, I am not saying that you do not change them as you have changed in the past 10 years, but as I understand you to say, you consider the past decade, at least projects of worthy concern, and I would imagine that you would feel that within the framework of a continuing change in society, that you would also say that you ought to continue them at the same high level in the next 10 years, is that right?

Mr. HOWE. I would hope that we might have the capacity to continue somewhere near the same level of dollars, if that is what you are driving at, but right now a considerable reduction in our annual grant giving appears a more likely outcome.

Senator HARTKE. I am driving at something entirely different, which is—I wanted to get you firmly fixed before I got you off on the deep end.

Mr. HOWE. I see.

Senator HARTKE. What I am saying to you is if you really are making such a valuable contribution in the past, and if that same level of contribution should be made in the future, and if, as a result in say, the next 10 or 20 years you dissolve yourself, is it more important to preserve the Ford Foundation or to continue the programs?

Mr. KENNEDY. Dissolution just means that you will not be able to do these valuable things 10 years after that, or 10 years after that?

Senator HARTKE. I understand that. I hear you. I hear you very clearly. I just asked you, and I think it is a rather difficult question to answer.

Mr. KENNEDY. Very.

Mr. HOWE. That is a very difficult question to answer, and one that our trustees have recently addressed. I can report to you that they have decided for the Ford Foundation that the problems of the year 2000 are probably going to be just as tough if not tougher than the problems that we have now. They believe, therefore, that it will be useful to have at that time an instrument like the Ford Foundation to make its contribution to work on those problems. So they are moving in the direction of saying that the Ford Foundation should not spend itself out of business but should curtail some of its spending and stay in business over time.

Senator HARTKE. Well, I think at this time it is sufficient to permit that to stay where it is.

I would like to put in the record, in line with that, my letter of September 23 to McGeorge Bundy, stating my concern over this very situation which you have identified, and the plight that is being faced by the foundations, and his reply to me.

[The information referred to follows:]

U.S. SENATE,  
COMMITTEE ON FINANCE,  
Washington, D.C., September 23, 1974.

McGEORGE BUNDY,  
President, The Ford Foundation,  
New York, N.Y.

DEAR PRESIDENT BUNDY: I was deeply concerned to note wire service stories which appeared in newspapers yesterday and today concerning the reduction in the Ford Foundation's assets.

As you are aware, the Senate Subcommittee on Foundations, of which I am Chairman, has been studying the role of private foundations in American society. From the time of our first hearing, nearly a year ago, I have been impressed by the many worthwhile projects which responsible and innovative foundations such as yours have funded. These have been people oriented programs which have concerned themselves with the many difficult social problems facing our Nation today.

Foundations serve as an important alternative to government initiative. As such, they have the freedom and the financial resources to act when government is reluctant to act, to probe into subjects which have not attracted the interest of government officials, and to question ideas and values which government refuses to question. Most important of all, they depend on a voluntary effort.

At a time when the recession in our economy and rampant inflation are causing some leaders of our government to suggest cutbacks in programs which affect people directly, we cannot afford to have one of the major alternatives to government support forced to reduce its involvement in those very areas of social concern.

There are presently more than 28,000 private foundations in the United States holding some \$28 to \$30 billion in assets. Together, these foundations made more than \$2 billion in grants in 1972. If the experience of these other foundations is anything like yours, they can expect their assets to be diminished to \$19 to \$20 billion and the public can expect as much as \$1 billion less in foundation

grants. Clearly, this will be a tragedy for the cause of social and economic justice at a time when the need is for more—not less—financial support.

Because of my concern about the impact which the current economic situation is having on private foundations and the activities they support, I would greatly appreciate any information which you may be able to supply about the causes of the Ford Foundation's present financial status. It is possible that the Subcommittee on Foundations will hold hearings on the impact of the current economic crisis on private foundations, and your contributions will be most welcome.

With my best wishes, I am  
Sincerely,

VANCE HARTKE,  
*Chairman, Subcommittee on Foundations.*

THE FORD FOUNDATION,  
*New York, N.Y., November 1, 1974.*

HON. VANCE HARTKE,  
*Chairman, Subcommittee on Foundations, Senate Finance Committee, U.S. Senate, Washington, D.C.*

DEAR VANCE: I am pleased to respond to your request of September 23 for information on the financial status of the Ford Foundation. At the outset, let me say that we share your concern about the diminution of assets of foundations as a whole. We also share your strong expressed concern over the effects of this situation on "programs that affect people directly" at the very time when there are reports of likely reductions in government outlays in areas of social concern. We hope the information contained in this letter and its enclosures will be helpful in your inquiry.

To provide a comprehensive analysis of the present financial condition of the Ford Foundation, I am enclosing a paper prepared by my colleague, Roger Kennedy, vice president for financial affairs.<sup>1</sup> The analysis examines the Foundation's condition in four respects, and can be summarized as follows:

#### 1. THE DECLINE IN NOMINAL VALUE OF THE FOUNDATION'S ASSETS

The nominal portfolio value of the Foundation's investment assets, in current dollars, has declined by more than 50% in the past decade, from \$4.1 billion in 1964 to \$2.0 billion at present. This decline has been due mainly to two factors:

the high rate of expenditure (averaging more than 8 per cent of assets per year) set by our Trustees over the years in recognition of the special obligations arising from our size and the pressing claims of the fields we have worked in.

the weak condition of the capital markets over the last nine years, and especially during the past eighteen months.

#### 2. THE EFFECT OF INFLATION ON ASSET VALUE AND THE VALUE OF OUR PHILANTHROPIC DOLLAR

In terms of 1963 prices, inflation during the past eleven years has eroded the real portfolio value of our assets by more than \$625 million beyond the decline in nominal value described above. It is estimated, furthermore, that the prices of the goods and services that foundations generally purchase through grant-making have increased by two percentage points per year more than the increase in the Wholesale Price Index. At this rate, the purchasing power of a grant awarded five years ago has declined by an average of 6 to 7 per cent per year.

#### 3. THE PATTERN OF PAYMENT OBLIGATIONS REMAINING FROM PAST COMMITMENTS

More often than not, the kind of philanthropic work the Foundation supports requires development and maturation over sustained periods of several years. As a result, most of our grants obligate us to make payments for periods of more than one year—in fact, unpaid balances of grants approved in prior years now stand at approximately \$259 million. This fact of life imposes a constraint on the speed with which we can adjust to severely changed financial conditions; any major decision to raise or lower the level of new grant commitments will take several years to be fully reflected in changes in the rate of expenditure.

<sup>1</sup> This paper was made a part of the official files of the committee.

#### 4. THE EFFECT OF THE FOUNDATION'S FINANCIAL CONDITION ON ITS PROGRAM AND INVESTMENT POLICIES

In order to maintain the Foundation as a continuing and active force in private philanthropy, it is clear that we must now slow down the rate at which our assets are being eroded by expenditures in excess of real returns. Thus, the decision facing the Trustees is not whether to reduce our commitments, but how much of a cutback is necessary and how heavily this cutback should fall on each of our programs. These issues will be addressed by the Board in the months ahead. Meanwhile, in an effort to sustain the earning capacity of our assets and to hedge against inflation, we have diversified our investment portfolio into bonds, real estate, and a wide variety of separately managed portfolios of equity and debt securities. Presently, almost 30 per cent of our assets lie outside equity holdings.

Let me turn, in conclusion, to the implications of current economic conditions for foundations generally since the double-barreled impact of deteriorating capital markets and two-digit inflation—as distinct from high payout—is by no means unique to the Ford Foundation. As you noted in your letter, “foundations serve as an important alternative to government initiative.” It should be a matter of some concern, therefore, that the strength of that alternative is diminishing, not only in this foundation but in others. This means there will be fewer funds from private foundations for experiments, demonstration projects, the nurture of creative talent, and the high-risk testing of imaginative ideas and approaches. Moreover, some provisions of the Tax Reform Act have both discouraged the formation of new foundations and led a number of existing foundations to dissolve.

The decline of private philanthropy is a sobering reality, deserving examination not only by those directly affected but by society at large. It is particularly significant, therefore, that the Subcommittee on Foundations of the Senate Finance Committee is planning to hold hearings on the impact of the current economic crisis on private foundations. It is also our hope that your committee will broaden its inquiry into voluntary philanthropic effort generally, because the role and condition of private foundations should properly be considered in the larger framework of which it is a part. In this respect, we are hopeful that the work of the Commission on Private Philanthropy and Public Needs (the Filer Commission), organized in 1973 and scheduled to present its findings in 1975, will contribute to Congressional review of the subject.

We are encouraged by the fact that the Congress already is considering what we regard as two important steps toward mitigating some of the effects of the financial crisis among private foundations. I refer to the proposed reduction of the 4 per cent excise tax, for the reasons you have set forth persuasively (Congressional Record, October 4, 1974, pp. S-18313-S18318), and to the proposed reduction in payout requirements. With respect to the tax, in the government's fiscal 1973, private foundations paid taxes totaling some \$76.6 million, while the IRS operating costs relating to its audits of all charitable organizations, including foundations, totaled approximately \$18.6 million. With respect to payout, modification of the present requirements would be particularly timely in view of the financial strains under which foundations are laboring because of the decline in the capital markets.

We hope that from your hearings may emerge other proposals for arresting the decline of the private philanthropic sector. One promising area, we believe, is the removal of disincentives that the Tax Reform Act of 1969 established to the formation of new foundations and the reinforcement of existing ones. In particular, this would be a propitious time to remove the limitations which the Act places on the tax deductibility of gifts to private foundations as against gifts to public charities. These limitations have created a second-class philanthropic citizenship for private foundations, to the disadvantage of the creative enterprises that must look to foundations for their seed money.

Indeed we hope that the present adversity may encourage Congress and others concerned with the vigor of a pluralistic system to devise affirmative incentives to private philanthropy.

We would be glad to furnish any additional information or to respond to questions on the information here submitted.

Respectfully,

McGEOGE BUNDY,  
President.

Senator HARTKE. In your statement are you telling us that while the Ford Foundation's assets have diminished substantially over the past 10 years, the likelihood is that the asset performance of most other foundations has even been worse?

Is that true?

Mr. KENNEDY. Senator, would you restate that?

Senator HARTKE. In other words, you say that the value of the assets of the Ford Foundation have substantially decreased over the past 10 years.

Mr. KENNEDY. Yes, sir.

Senator HARTKE. But you say that the assets of other foundations have even decreased more, is that correct?

Mr. KENNEDY. Yes, sir, that is correct. We were speaking of performance measurement, which tells us what happens to the given amount of money that you have when you start measuring. We weren't talking about absolute size, because, of course, some foundations have additions from new gifts during a period and some don't.

In the case of the Ford Foundation, its assets were pretty well fixed, that is, what it had to work with was pretty well fixed 10 years ago, and what has happened, per dollar invested, has been that it has done relatively well per dollar invested.

On a basis of performance per dollar, yes, relatively speaking the Ford Foundation has done well.

Senator HARTKE. What I am really asking you is, what advice do you have to those who have not done so respectably well, and I know I am putting you in the box of trying to brag about your own house, but you know, if you have done a good job, why not go ahead and tell us why and how it could be done by others.

Is that not what you are saying?

Mr. KENNEDY. No, sir, I guess it is not.

Senator HARTKE. No, I did not say you wanted to tell others. Are you not really saying you have done a pretty good job?

Mr. KENNEDY. No, I cannot even say that. We have done the best we could, and it is relatively OK, but surely in ten years experience we and everybody else, professional investors in this country, could have done a whole lot better. We are just not too proud of ourselves.

Senator HARTKE. All right. We have a letter from your president, McGeorge Bundy earlier this fall in which the position of Ford Foundation was that more time was needed before there could be any change in the minimum distribution rule which was contemplated.

Now, today you have said that a modification at this point would be especially timely.

What has happened in the interim period to have that change of position?

Mr. KENNEDY. Well, we all learn as we go along, and we keep on learning.

Senator HARTKE. You learn that you should not have made that statement in a letter, is that what you are trying to say?

Mr. KENNEDY. No, sir, we hope we keep on learning.

The body of information we have available and experience keeps changing and we learn with it.

Senator HARTKE. Well, is there anything special that has happened in 2 months that has made you—

Mr. KENNEDY. No. I do not have the text of the letter in front of me, but what I understood it to say was that there was a body of data, being developed, and had been developed in recent years, which is very important in what it tells us about what total returns had been. Dr. Goheen presented a lot of that this morning, and some of it is in our prepared testimony. We figured the best thing we could do today was to state the facts of history as we now know them and try to get those clearly established in the record.

Sure, we think that that formula needs adjustment, but we think it ought to be done on the basis of long term experience.

Senator HARTKE. Mr. Howe, let me ask you, if there is this reduction in grants by the foundations, will it have a sharp impact on what we call socially oriented programs?

Mr. HOWE. Since a fairly high proportion of our grants are for what you would call socially oriented programs, certainly the reduction that will come in our annual spending will have that effect, and it will be true of a number of other foundations.

I think also it is important to point out that almost any foundation has what I call in my testimony future commitments, which are not firm promises but which are obligations of an informal kind to organizations with which it has had grantor-grantee relationships. As our annual spending declines, those future commitments use up a larger proportion than usual of our annual funds, so that the money available for what we might call new starts or responses to bright ideas from outside is smaller. There is some tendency, therefore, as annual expenditure declines, to continue in the lines we are in because of the obligations we have, and to be less responsive to lively ideas that really need backing, not because we do not want to respond, but because we don't have the capacity.

Senator HARTKE. All right.

Let me ask you, will the innovative programs be the real first victim?

Mr. HOWE. No; I do not think it is fair to say that because I think some of the continuing programs you would describe as innovative programs, but I think new starts, be they innovative programs or be they bread and butter programs—

Senator HARTKE. That is what I really mean. In other words, an ongoing program which is innovative will continue, but really the new starts in innovative programs will be the first to go.

Mr. HOWE. They will have a more difficult time, sir.

Senator HARTKE. And those who are socially oriented would be in that line. They would have a tendency to go back to the more traditional approaches.

Mr. HOWE. I would not necessarily agree with that last point. I think that our broad policy directions, for instance, a major concern for racial equity in American society is going to continue. We will have programs that are concerned with minority groups and their problems in this society, and we will continue to support them, but we will not be able to give them as many new starts as we would like.

Senator HARTKE. Which may have an effect on achieving that racial equality that you were talking about.

Mr. HOWE. It might have some effect.



Senator HARTKE. We have a vote going, but in line with that, I might just say that my own judgment is that the first great experiments in racial relationships on a massive scale is occurring in the United States, and those who criticize what is going on here frequently ought to think twice: if we are not successful in this experiment here, then the tragedy of racial differences which would occur when it is not a black-white situation but a white-yellow situation would be even more severe than anything that has traumatized us in this generation.

I do not have any more questions, and I am going to recess to go vote. Senator Fannin is going to continue these hearings, and I want to apologize for the fact that I have got to leave, but my choice is not one of my own.

Senator FANNIN. Mr. Chairman, I would just like to say, as far as further questions to the gentlemen that are testifying at this time, I have no further questions because I did not have the privilege of being here during this time and I do not want to hold you any further.

Senator HARTKE. I really want to thank you. You will be in good hands with Senator Fannin. I just want you to know he is a good man.

Mr. HOWE. Thank you.

Mr. KENNEDY. Thank you.

[The prepared statements of Messrs. Kennedy and Howe follow. Hearing continues on p. 107.]

THE PREPARED TESTIMONY OF ROGER G. KENNEDY, VICE-PRESIDENT FOR FINANCIAL AFFAIRS, THE FORD FOUNDATION

Mr. Chairman, I'm grateful for the chance to respond to your invitation to testify.

This is written at the end of a year in which the Ford Foundation expended \$250 million, more than 14% of its assets as of the end of our fiscal year, September 30. This completes a decade in which average annual "payout" was about 8½% of assets at the end of each fiscal year.

That has diminished our size. About \$2 billion in excess of interest and dividend income has been expended for charitable purposes since the Foundation became a large philanthropy in 1950.

During the last five years capital markets, both stocks and bonds, have produced substantial capital losses. Within these markets the Ford Foundation's portfolio performance wasn't bad: we were diversified among stocks, bonds and real estate and were probably in the top quartile of managed funds over-all, slightly better than that in comparison to mutual funds alone, including balanced and growth funds.<sup>1</sup> Yet today, in terms of the real purchasing power of its assets, the Foundation is less than 17% as big as it was a decade ago. The complex cumulative story can be summarized in a sentence: we have expended at an average annual rate of 8½% of our assets for a decade while total returns have been very, very small and while inflation has eaten away purchasing power at a 4% annual average rate.

When we began the decade we had assets of \$3.8 billion. Today we have \$2 billion. With that amount of money we can buy less than 35% of that market basket of goods represented by \$3.8 billion in 1965 and 17% of that of the sort of services upon which most nonprofit institutions actually spend most of their money (according to the Malkiel study for Princeton or the Glauber and White study for Harvard).

All during this period we have accelerated our efforts to diversify our portfolio into real estate, managed bond portfolios, and out of Ford Motor Company stock; we husbanded reserves and set our sights on lower budgets; but we could not do enough. From 1968 through 1973 the *dollar raté* of expenditure fell but the

<sup>1</sup> We're talking here of "managed assets"—about half the Foundation's assets were not fully manageable until the late 1960's. The Foundation has been divesting itself of "un-manageable" Class A Ford stock, which was unregistered and not readily marketable.

percentage rate of expenditure did not. Here are the dollar expenditure rates and the percentage of assets expended :

	1974	1973	1972	1971	1970	1969	1968	1967	1966	1965	1964
Total expenditures..	300.3	244.0	263.0	268.0	285.0	287.0	270.0	192.0	229.0	262.0	216.0
Total portfolio (Oct. 15).....	2,000.0	3,049.1	3,279.8	3,260.0	2,833.5	2,915.9	3,600.0	3,538.1	3,015.4	3,846.2	4,073.4
Percentage payout..	14.4	8.0	8.0	8.2	10.1	9.9	7.5	5.3	7.5	6.8	5.3

The point to be stressed is that our average annual rate of expenditure was about 8.5%, a very high figure for philanthropy, much higher than the 5½% characteristic of most other large foundations or university endowments.

With a portfolio manager's hindsight, it's obvious that was too much. But from a social historian's point of view, it may not have been. There can be no such thing as "overexpenditure" if the money goes to achieve the purposes for which the institution exists, and if it is spent today to meet needs greater in importance than those for which it might be spent tomorrow—the beneficiaries of charity would hardly argue that at least in their own cases the giver had been improvident. Four and a half billion dollars of the Ford Foundation's money has been expended to serve the needs of the country and the world, much of it in the last decade.

So much for expenditure: now let's look at the history of returns.

The long-term history of investment returns must be stated at some length because much of the data have not been available and widely accepted until quite recently. In their absence all investors had inadequate statistical material with which to extrapolate into the future the experience of the past. We are all painfully aware that total returns—dividends and interests plus capital gain or loss—have been disappointing for the past five years, but it is useful to draw back from recent turmoil and observe that the gap has been widening for quite a while between great expectations and what investors actually got. Here is the record of total returns from common stocks in the Standard & Poor's 500 list at five-year intervals over the past twenty-five years:

	Nominal total return (percent)	Inflation (GNP deflator)	Real total return
1949-54.....	21.0	2.5	18.5
1954-59.....	18.5	2.5	16.0
1959-64.....	10.3	1.4	8.9
1964-69.....	5.8	3.5	2.3
1969-74.....	-1	5.7	-5.8

Let us see how a portfolio distributed 50% in stocks and 50% in bonds would have fared over the same spans:

	Nominal total return (percent)	Inflation (GNP deflator)	Real total return
1949-54.....	11.5	2.5	9.0
1954-59.....	8.6	2.5	6.1
1959-64.....	7.3	1.4	5.9
1964-69.....	1.9	3.3	-1.4
1969-74.....	2.2	5.7	-3.5

I've added bar charts to show the relationships of stocks and bonds (both expressed through the Standard & Poor indices) and inflation (expressed through the GNP deflator) not in five but in ten-year recent spans—first before deducting the inflation rate from total returns ("nominal"), then after doing so ("real").

What about a still longer perspective? What has been available for payout of real total return (dividends plus interest plus capital growth, less inflation) over fifty or a hundred years? The story is not much different. Funds invested

broadly in American capital markets over long periods have yielded  $4\frac{1}{2}\%$  to  $5\%$  in real total returns.

The well-known Lorie-Fisher study for the University of Chicago showed total returns from an unweighted "index" of all New York Stock Exchange stocks from 1928 through 1968 of  $7.3\%$  without reinvesting dividends. The rate of inflation was about  $2.3\%$  annually for that period. Roughly extrapolating the same data base to the present would bring total returns to less than  $5\%$ . A capitalization weighted index (the Standard & Poor's 500 Stock Index) shows real total returns of  $5.2\%$  from 1929-1973. Nicholas Molodowsky's data for 1871-1970, extended into 1974 by applying to them relevant portions of Peter Bernstein's study of the span from 1901-1973, indicates real total returns from a broader list of stocks over a longer period between  $4\frac{1}{2}\%$  and  $5\%$ . All these figures, clustering in that range, are consistent with Philip Cagan's recent work on real total returns for the NBER reported in their Supplement #13, March 1974.

It is quite natural that we should ask, after a year of disaster in capital markets, whether we are teetering into the future without pausing to recover our nerve and perspective. Why won't it all come back quickly? It may, but we have seen that in the U.S. total returns have been declining from common stocks and from balanced portfolios for twenty-five years, not just one year or five.

It is not just the past year which has led us to reconsider our targets and our total return expectations, but all that we have learned over a decade or more.

Is it true, as is so often said by eager brokers, that "price/earnings multiples are at an all-time low"? The answer is: it is not true. Nor is it true that "stocks are cheap by any historic standard."

The facts are that common stock earnings are much more expensive today than they were, for example, in the period 1948-53; price/earning multiples on the Standard & Poor's 500 Stock Index are about eight times today, and they were as low as six times during that period. They were often in the present range during each decade of the 20th century.

It is also true that stock yields are today, seen against history, in a normal range relative to their primary competition, yield from bonds. It has taken a long readjustment to that competition to bring us here, and a further upward movement in bond yields could force even more.

Comparative figures for all endowments, collated with mutual funds, are produced only at six-month intervals by the computer at the Tuck School at Dartmouth, and the most recent figures are for June 30, 1974, before the deepest pit of the year in stock market action. For the five years ending then, the total Ford Foundation portfolio ranked ninth out of 167 endowments reporting. This result was enhanced by the relatively strong record of the Ford stock during the early part of the period. Omitting Ford stock, the Foundation's managed portfolio was twenty-eighth out of 168. The Standard & Poor's 500 Stock Index would be in position forty-six. More recent Becker numbers indicate those managed assets would have been in the top quartile, had it been a pension fund, over five years. We know that ours has performed as well as or better than any other large diversified philanthropic endowment for the past year or for five.

From the narrow perspective of a portfolio manager, it might be said that the Ford Foundation has given away more money than it should over the years; but it has done so for the purposes for which the Foundation was created. Inflation has eaten away even more of the Foundation's assets, a story twice and thrice told by now. And capital markets haven't helped enough to restore those losses. Better than average performance wasn't enough to compensate for both inflation and expenditure. Looking back, philanthropy can be proud of what it has contributed (to pick a few beneficiaries which come to my mind) to the defense of constitutional rights, to black colleges, to food and family planning (inextricably intertwined), to ballet, symphony and decent housing. These contributions have been at the expense of assets, and future contributions must therefore be reduced. Harold Howe will talk about where that is likely to happen, but on the financial side, let me suggest a few things Congress can do to help diminish the injury to philanthropy which has been wrought in recent years:

First, it's encouraging that you are examining a reduction of the  $4\%$  excise tax, for the reasons you have set forth persuasively (*Congressional Record*, October 4, 1974, pp. S-18313-S18318), and a reduction in payout requirements. With respect to the tax, in the government's fiscal 1973, private foundations paid taxes totaling some \$76.6 million, while the IRS operating costs relating to its audits

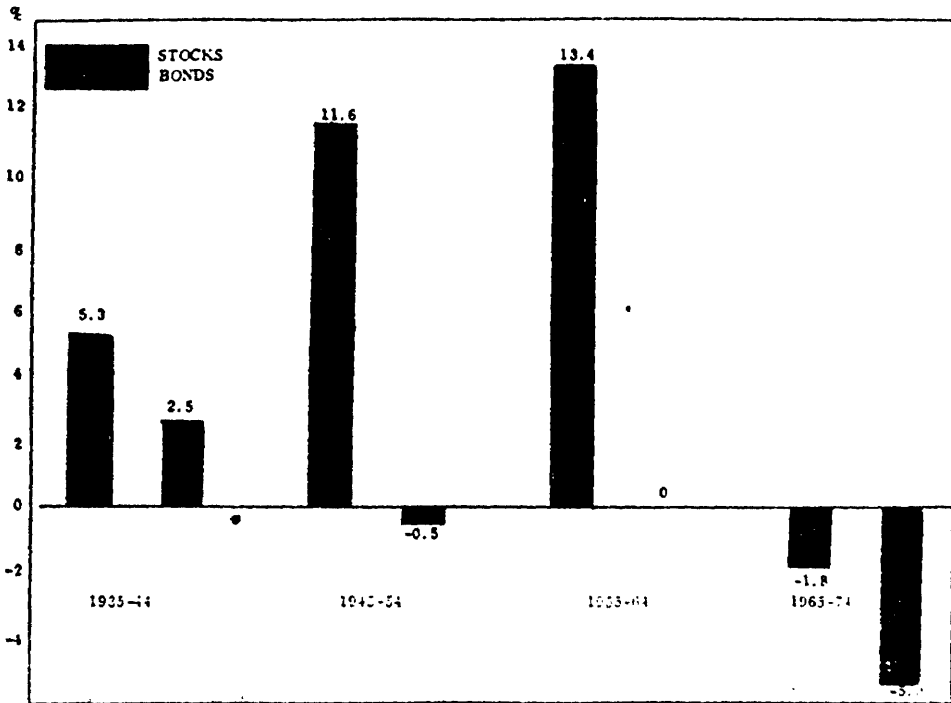
of all charitable organizations, including foundations, totaled approximately \$18.6 million.

Second, with respect to payout, modification of the present requirements would be particularly timely in view of the financial strains under which foundations are laboring because of the decline in the capital markets.

Third, it would be very helpful to charity if there could be removed those disincentives that the Tax Reform Act of 1969 established to the formation of new foundations and the reinforcement of existing ones. In particular, this would be a propitious time to remove the limitations which the Act places on the tax deductibility of gifts to private foundations as against gifts to public charities. These limitations have made private foundations into second-class philanthropic citizens, much to the disadvantage of the creative enterprises that must look to foundations for help.

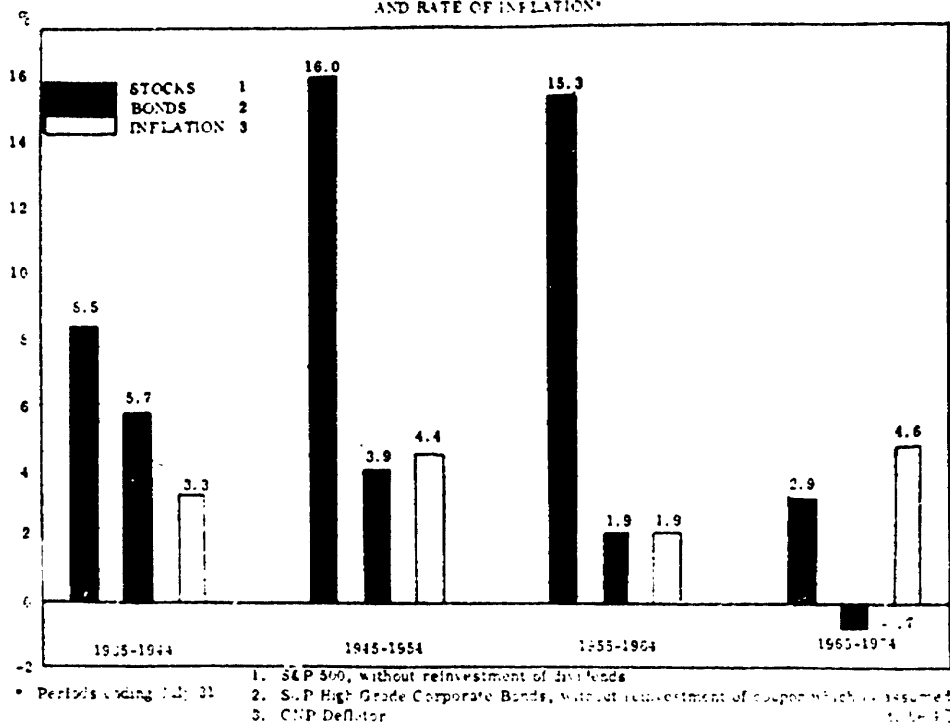
These three steps, if taken, could help these private institutions continue to serve the public welfare. They would be: reduction of the tax on foundations, modification of the payout requirement, and removal of disincentives to the formation of new foundations.

TOTAL REAL\* RETURNS\*\*  
S&P 500 STOCKS AND HIGH GRADE CORPORATE BONDS



\*Nominal returns less rate of change of GNP deflator

\*\* Without reinvestment of dividends or income

TOTAL NOMINAL RETURNS FROM STOCKS AND BONDS  
AND RATE OF INFLATION\*

**PREPARED TESTIMONY OF HAROLD HOWE II, VICE PRESIDENT FOR EDUCATION  
AND RESEARCH, THE FORD FOUNDATION**

The notice announcing these hearings points out that the Senate Finance Committee Subcommittee on Foundations is concerned not only about the effects of the current economic crisis on foundations but also understandably about the effects on the recipients of foundation grants. My observations are entirely about the latter—the problems of non-profit institutions that depend upon philanthropy in a time that combines both inflation and recession. This statement addresses itself to the following points:

1. The scope and role of philanthropy in general and of foundations in particular in the United States;
2. The impact of the current inflation/recession on philanthropy and on its beneficiaries;
3. Examples of the kinds of activities that are suffering and that will suffer in the future as foundations curtail their giving; and
4. A brief comment on remedies that would help the situation.

Although this hearing is specifically focused upon the problems of foundations and their grantees, I have to use the broader concept of *philanthropy*, a term that covers all private giving from individuals, corporations, and foundations, to give any sense of the impact of our current economic crisis upon a variety of

agencies and institutions that are vital to this country's future and freedom. One of our most treasured traditions in the generous application of private funds to the needs and problems of people as well as to the maintenance of religious, educational, civic, and cultural institutions and services. In 1972, private giving in the United States for these purposes totalled \$22.7 billion<sup>1</sup>—more than double the philanthropic dollars of ten years earlier. In the current year, a reasonable estimate for philanthropy in the United States is about \$25 billion. Based on the figures from 1972, this vast sum to support a variety of religious, educational, charitable, and scientific purposes will come from the following sources (the percentages are approximate) :

- from individuals—75 percent
- from bequests—12 percent
- from foundations—10 percent
- from corporations—3 percent

The existence of this \$25 billion annual philanthropic sector in the United States is unique in the world. No other country has anything like our record of spending annually about 2 percent of our gross national product in tax exempt funds through decentralized, private decision making. While this is not the place for a review of all the activities this money supports, it is important to respond here to those who claim that private money is not significant and could be better expended by public agencies. The fact is that if the tax exempt funds distributed by foundations and other philanthropies were to accrue to government, there is simply no possibility that they would be used to benefit many of the deserving and needy organizations and individuals that depend on them. Their use would be decided by the political system we have for determining public priorities which could not and would not use them in the way private philanthropy does. We are fortunate in the United States to have a dual system for applying resources to human needs—a public system and a private one. These two systems complement and strengthen each other, and the decline of either would be a tragedy for our society.

As more and more public money has been used by cities and states and particularly by the Federal Government in recent years to work on the economic and social problems of people in the United States, private philanthropy has had a parallel, healthy growth. The need for it seems to have increased rather than declined with the development of publicly-supported social programs. Sometimes it has augmented public funds as in the matching provisions of the Arts and Humanities Endowments; sometimes it fills the gaps left by inadequate income from public funds and from client fees as in the great private voluntary hospitals of the country or the private colleges and universities; sometimes it provides funding that leads the way for larger government funds as in the Children's Television Workshop that produces Sesame Street or the grants from the Rockefeller Foundation that led to scientific breakthroughs in wheat growing and their spread around the world with help from public funds; and sometimes private funds are the only possible source of support for independent analysis of the effects of large-scale government efforts or for research on social problems that need clarification before government can act on them. Particularly in this latter area, foundation funds are especially significant. Gunnar Myrdal, a Swedish economist, was supported in his broad study of the racial issue in American society by a private foundation—the Carnegie Corporation, and he made a major contribution to social progress in this country. The recent Energy Study supported by the Ford Foundation has both admirers and critics, but few deny that it has advanced public understanding of one of the most crucial issues before us. Without laboring the point further, a case can clearly be made for the special contribution of private philanthropic funds to the diversity, the quality, and the relative equality of life in the United States, though it is abundantly clear that much remains to be done in all these respects. Today about 10 percent of these funds come from some 25,000 private foundations.

This discussion puts the foundation dollar in the perspective of the country's total philanthropy, of which foundations are a small but important part. All of philanthropy is under special stress in today's economic crisis, and the beneficiaries of philanthropy are what I would describe as "double losers." First, their benefactors in general have reduced incomes and reduced capital gains and can give them less money. Second, the money that they get will buy them less

<sup>1</sup> 1973 Annual Report of American Association of Fund-Raising Counsel, Inc., 500 Fifth Avenue, New York, New York.

than it did before because of inflation. Indeed, it would not be inaccurate to describe hospitals, colleges, performing arts companies, and other such beneficiaries of philanthropy as "triple losers." For not only do they face the hazards of smaller grants and higher costs, they also have built into their operations what the economists call a "labor intensive" characteristic. This means that they cannot realize many efficiencies by investing in labor-saving devices. Any labor intensive enterprise has a doubly difficult time during an inflationary period. But there isn't any other way to run a dance troupe or a symphony orchestra or a hospital or a university.

During the ten-year period from 1963 through 1972, the annual increase in philanthropic giving in the United States was large enough to protect the beneficiaries of philanthropy from inflation and to provide some small additional funds each year for expanding services. Using 1967 constant dollars as a measure, there was a growth in all philanthropy from \$11.64 billion in 1963 to \$18.1 billion in 1972. Figures are not yet available for the years 1973 and 1974, but my estimate would be that inflation has been so rapid in those years that philanthropic giving has almost certainly fallen behind and failed to maintain a growth rate that will give its beneficiaries the same income in constant dollars that they received in prior years.

These generalizations about the broad field of private philanthropy apply to that portion of philanthropic activity that is supported by private foundations. In addition, there are some points that can be made with specific reference to the grantees that are particularly served by foundations. Their largest beneficiaries are in the fields of education, welfare, and health, which together attract about 70 percent of foundation money, with education getting the largest slice.

The funds that go from foundations to education support a great variety of purposes and activities. Some of them provide scholarships and fellowships for deserving young people. (In the Ford Foundation, we are spending about \$10 million annually for this purpose.) Other funds build buildings, pay salaries, go into endowment, encourage particular reforms and experiments, or support research. Sometimes foundation funds are the most useful money a college or university has because they are quickly available to do something important for the institution at a time when the idea and the people to carry it through are ready.

For the next five years and probably for longer than that the Ford Foundation will be forced to do less for education. While our future expenditure plans are not yet firm, they clearly will involve reduced annual budgets for education, just as they will for the other major areas of work in which we have been engaged. I expect that other foundations may face similar problems though perhaps to a lesser degree. This difference grows primarily from our rather heavy expenditure of capital in recent years.

One effect of declining foundation funds for education is to reduce what I would call the "venture capital of education"—the money available to try some idea or project or to promote some study that might help education to do a better job, to serve its varied constituencies more effectively, or to adapt itself to a changing employment picture. For example, a significant portion of the Ford Foundation's education funds are used to promote both efficiency in the management of schools and colleges and equity in the distribution of public funds for the benefit of portions of the population that have long been treated unfairly. While we plan to meet all the commitments we have made in these areas, we shall inevitably do less than we currently are and less than is desirable.

The fact that we have some future commitments illustrates another point about the limitations of foundation funding during a period of economic stringency. We and many other foundations tend to have such commitments. These are frequently not formal promises, but they are obligations in the sense that we have helped to launch programs in schools and colleges or in other agencies that cannot succeed unless they receive continued support. At any given time we try to avoid having these future commitments dominate our budgets so that we can have adequate funds each year to support interesting new ideas that come to us. But with declining annual funds, our obligations to existing grantees tend to dominate our spending and bright ideas from potential new grantees have tough sledding. I know of a number of other foundations that have similar problems, and I suspect that the domination of grants by existing grantees and the rejection of new and interesting possibilities is currently a feature of many foundation programs. The result may be that foundations as sources of innovation and change become less significant during a period of declining budgets.

Not that every foundation is engaged in the business of promoting innovation—many are simply helping institutions to survive by grants that pay their bills or assume some of their capital costs for construction and equipment. Some of the activities of the Ford Foundation have this bread and butter aspect, and are, we think, worthwhile because of the significance to human welfare of the agencies involved. But it is obvious that these activities also are handicapped by the joint effects of inflation and lowered foundation income.

Private colleges, which depend upon a combination of donations and student tuition to pay their bills, are facing increasingly serious problems. The donations are inadequate and pushing tuition higher can only result in enrollment declines that will be self defeating. Every month or so another private college goes under. Eisenhower College was recently rescued by the Congress probably because of affection for the man the College memorializes. New College in Florida, a private institution to which the Ford Foundation gave \$1 million several years ago, was not so fortunate; it has gone under and been absorbed by the State.

Private universities face erosion of quality and possible major surgery, as in the case of New York University. Some are conducting massive drives to raise private funds, but even if those drives are successful, the eroding effects of new levels of inflation will make them less useful to the universities than when they were originally planned.

I do not believe the private philanthropy by all sources put together will be able to solve all the problems of the private educational institutions of this country; but I do believe that a healthy and vigorous philanthropic base is necessary if those institutions are to continue to serve the special and unique purposes that so many of them do.

There are other examples outside the realm of education to illustrate the effects of the economic crisis on foundation programs. For the past two decades the Ford Foundation has supported programs to assist state and local governments to deal more effectively with the multitude of new problems which they have had to confront in recent years. In this connection, the Foundation has given substantial support to the work of the Citizens Conference on State Legislatures, League of Cities, Conference of Mayors, International City Management Association, National Association of Counties, National Civil Service League, Council of State Governments and to various academic centers working directly with local governments. Illustrative of the purpose of these grants have been efforts to modernize the structure and operations of state legislatures, experiments in ways of using new technology in local government operations, the establishment of standards and techniques for measuring and improving productivity in local governments, the assessment of the importance of the new federalism in revenue sharing and explorations in regionalizing various governmental functions. Ford Foundation support for all of these programs will be terminated in the next year or so in order to permit the Foundation to concentrate its limited resources in other more critical program areas.

As for the creative and performing arts, it is too early to tell whether the economic crisis will mean an overall national decline in foundation giving. There is a special—and intrinsically not helpful—reason for this. Few national foundations have made the arts an important priority. The largest of these, the Ford Foundation, is currently budgeted in the arts about one-quarter below its average for the 1960s and early 1970s. The Ford Foundation surely will not be able to play again the kind of one-time role exemplified by its capital grants to symphony orchestras, or its sustained long-term grants to selected non-profit theaters and ballet companies. It is not yet clear whether and how it will be able to help with any operating budgets even selectively.

Local and family foundations are often the medium for private patrons, and thus far private patronage of the arts has held up fairly well. But as has been noted, the arts are also labor intensive and therefore are meeting a rate of inflation somewhat higher than that in the economy generally. The most heavily documented of recent national studies, the Ford Foundation's study of the financing of the non-profit performing arts, shows that by 1981 every potential source of support—private patronage, foundations, federal, state and local governments and corporations must engage in larger efforts just to maintain the current level of activities.

Foundation work in the international field is handicapped also. At a time when this country and the world are deeply concerned about threats of famine, energy crises, a tottering international economic order and recurrent threats of war,



the small number of foundations like ours that have been engaged in international activities seek to keep up our help where we can. We are seeking to maintain at the best level we can our help to those struggling with the linked problems of food and population around the world, but to do so means that other support must diminish. In particular, we have had to diminish our support to the great centers of international studies which equip this country to understand the wide world; there was a time when we could provide great universities like Chicago, Berkeley, Columbia, or Harvard with as much as \$1 million a year each for these studies, but now can foresee only very small fractions of such sums.

Mr. Chairman, philanthropy is no different from any other economic activity in the United States—when the economy is reasonably healthy and when inflation is under control, it can play its part responsibly and effectively. When the economy is in a decline and inflation is rampant, philanthropy suffers and so do its beneficiaries. So the basic remedy for today's problems in the world of foundations and of benefactors generally is the same as the remedy for business, for finance, and for the individual citizen. It involves mounting on a national scale appropriate efforts to slow the rise of prices and wages, to encourage savings, to meet special emergency problems like that in the energy field, to ward off recession, and to build citizen support for these endeavors so that they will succeed.

Aside from large-scale actions and government policies that will help to return our economic system to some degree of order there are two actions that you might consider to help those who are helped by philanthropy. One is to make sure that tax policy does not inhibit giving to non-profit agencies by individuals and corporations, and the other is, as you have previously recommended, to reduce the levy on the income of philanthropic foundations that the Congress placed in the 1969 Tax Reform Act. This tax at its current level is not serving the public interest, while a reasonable fee to cover the costs of regulation would be quite sensible.

Senator FANNIN. The hearings will come to order. The next witness, Mr. John Huffaker, attorney.

Mr. Huffaker, I want to apologize to you and to the other witnesses for this delay. You have been very, very patient, and I hope that we can move along rapidly. I do not say that in trying to rush you, but I hope we can hear all of the witnesses this evening.

#### STATEMENT OF JOHN B. HUFFAKER, ATTORNEY

Mr. HUFFAKER. We are all aware of the hour, Senator, and I will be as brief as we can. Please include my printed statement in the record.

I am John B. Huffaker, a partner in the law firm of Pepper, Hamilton & Scheetz. In my practice I have been closely involved with foundations; some of whom are members of the Council on Foundations.

I am going to focus solely on the procedure by which we vary the required payout by foundation from year to year. The statute provides a 6-percent rate and then a percent referring to changes in money rates and investment yields, so that the payout in any year is to be a relationship between money rates and investment yields in the immediate preceding year and those of 1969.

Through the sharp eyes of Senator Hartke's staff, there has been made available to us a letter to the Senator dated November 22, 1974, from Mr. Hickman, Assistant Secretary of the Treasury Department. This letter points out that the Treasury Department's view of this year-to-year adjustment is that it should be made by relation to the changes in the value of 5-year Government bonds.

Therefore, the rate for next year is expected to be 7 percent or a little bit more. This represents approximately a 25-percent increase in the required payout rate.

For private foundations, we feel that this requirement of a 7 percent plus payout next year represents a misinterpretation of the congressional intent when the minimum payout rules were enacted.

I will ask the Senator to remember the hearings before the Finance Committee when Mr. Peterson presented the Peterson report. You remember, sir, he put it up on slides on the wall and so forth.

Senator FANNIN. Yes.

Mr. HUFFAKER. Now the Peterson report had an excellent analysis in it in some ways and not so excellent in others. It purported to demonstrate that the foundations could pay out 6 percent per year. Now this was based upon two elements.

It was based upon an element of about 3½ percent or 4 percent of ordinary income, and about 2 percent or 2½ percent of capital gain.

Now attached to my testimony is a table, Senator, that shows—the first table, Mr. Marlowe—

Senator FANNIN. What page is it on?

Mr. HUFFAKER. It immediately follows page 11, which would be page 12.<sup>1</sup>

Senator FANNIN. All right, sir, we have it. Thank you. If you would proceed.

Mr. HUFFAKER. This table is based upon the Standard and Poor 500-stock average, which is a very representative average. The figure all the way over in the right-hand column, "Net Annual Return," takes into account three elements: ordinary income capital growth, and inflation, well I will just summarize.

Senator FANNIN. All right, please.

Mr. HUFFAKER. This column of this table shows that based upon the Standard and Poor average, if you take into account three things: the ordinary income, the growth in value or loss in value during the year, and inflation, that for the period from 1958 through 1968, there was actually an average real income this year of more than 6 percent. If we take that up to date, it is only 4.5 percent.

But this is based upon the income equivalent composed of the two factors, ordinary income and capital appreciation. Now I think that Senator Curtis will remember that following the report of the bill, when the Finance Committee stayed with 5 percent, Senator Percy offered an amendment to the floor to raise it to 6 percent. Senator Curtis unsuccessfully opposed it, but Senator Percy stated, this is not intended to be a death-wish for foundations, but if you invested your money wisely, you should realize a real return of 6 percent.

Now let us look for a moment at what the Treasury Department is proposing in a letter to Senator Hartke today. The letter to Senator Hartke says that for next year we are probably going to have an income minimum payout of 7 percent or more.

Now, then, this is at a time when our ordinary income has certainly gone up as a percentage yield. Common stocks are now yielding 5 percent on the current average, rather than 3½ percent, but when they raise the income payout by 1½ percent, what they are telling is that

<sup>1</sup> See page 114.

in a very bad market, when we are all having decreases in value, we must invade corpus more-or-less the same amount that we would have been invading corpus in basically a good year.

Senator CURTIS. Now by the same amount, you mean the same dollar amount.

Mr. HUFFAKER. No, sir, the same percentive amount because what they have done is propose to increase the minimum payout percentage by just about the same amount that our ordinary income did increase, so the difference between the income we will be getting and the required distribution will remain about 2 percent of corpus, and I think that is wrong because if Secretary Cohen and Mr. Percy knew what they were talking about when they were here, they said we are looking at your total income, and that is your ordinary income plus the growth.

Now the Treasury Department does not propose to take in account, in fixing the payout, the complete lack of growth. This really threatens the ability—

Senator CURTIS. In other words they are following a rule that if growth increases the payout, we consider it. Lack of growth we will not consider in order to lessen the payout.

Mr. HUFFAKER. I am not certain that is true, Senator. What they are saying, at least, where there is lack of growth, they are not cutting it down for any lack, The formula itself has built into it an assumption of a certain amount of growth.

Senator CURTIS. Well, it does amount to this, that growth or the lack thereof is considered a factor to increase the payout, but not considered a factor to decrease it.

Mr. HUFFAKER. They seem to be relying completely on current income, compared with current income in 1969, whereas the committee in fixing the percentage was looking not only to current income, but also to capital appreciation.

Now I would like to commend to the committee's attention your bill, Senator, S. 3927, which would, among other things, have substituted exact percentages for those which would be flexible from year to year, and I think that would go a long way to removing the very difficult problem that we will be confronted with next year. I would be hopeful that there would be a chance for an amendment or something like that, even this year because there is a technical gaffe in the statute. The formula just does not work. The formula does not respond to the lack of appreciation. The formula as construed by the Treasury reacts only to income, and that simply is not the way the committee was thinking.

There is another graph<sup>\*</sup> here that shows—just behind the one before you, Senator Fannin—

Senator FANNIN. This graph?

Mr. HUFFAKER. Yes, sir. Now that shows the basic fallacy in the way the Treasury is thinking. The real line that starts at the bottom is the gross national product deflator. The line just above it, prime commercial paper—you will notice how generally how the prime commercial paper rate and the GNP deflator move the same way.

Now that really reflects interest. That reflects—now you will notice the corporate bond line, which would be very similar to the 5-year government line, moves with, but shows greater stability. But you will see toward the end, the dramatic increase in yield in corporate bonds.

<sup>\*</sup> See page 115.

Now you will see all of these things really are not a function of your ability to grow. It is a function of inflation, and inflation is reflected in money rates. What we are seeing right now are high yields because people fear inflation.

Senator FANNIN. Of course, we did not anticipate, as you well know, what has happened. The tremendous change that has come about, especially in the last few months and year, was never anticipated when we were writing this legislation. I am very concerned as to just what can be done to make changes because you know, we are coming to the end of this session. Is your thought that something should be done immediately? We are up against a time schedule that is almost prohibitive.

Mr. HUFFAKER. We have in the Peterson report, an assumption of inflation of 1.6 to 2 percent which now seems like it must have been in another world completely. What we are hopeful could be done would be a very simple time buying bill, such as Senator Curtis S. 3927, that would take us out of the variable percentages for a few years. If it were 4.5, 5 percent, almost any fixed percentage for a number of years, at least it would take us away from dependency on a formula that does not reflect this new world of inflation.

Senator FANNIN. Well, I certainly understand the seriousness of this change that has come about, but I am just hesitant to make any commitments as to what can be done in the time remaining. I do not know what Senator Curtis has in mind in his legislation or whether or not he had in mind anything being done this year.

Senator CURTIS. Well, it was my hope, but realistically, I do not know what is going to happen. We are about to go on recess again, but certainly this is urgent. We are aware of that. I believe that the mandatory payout, if it is going to be continued, must be lowered, and I also am indebted to you for calling attention to the fact that a fixed rate is advantageous. It would enable foundations of all sizes to more wisely manage their portfolios, but that is a fixed figure that they could rely on.

Mr. HUFFAKER. I think it would be a major improvement, Senator, and we hope you have a chance to consider it as early as possible.

Senator CURTIS. I hope so, and I hope we can reduce it.

Mr. HUFFAKER. Thank you, Senator.

Senator FANNIN. Mr. Huffaker, we greatly appreciate your recommendations to substitute a fixed formula for the variable formula.

It seems sound as far as we have gone and I understand as your report shows that the Ways and Means Committee had reported to a prior Congress, so we have precedent for that, and I would just say that this information will be carried to the chairman and to other members of the Committee. We cannot make any commitments about what we will be able to do in this session.

Was there anything further?

Mr. HUFFAKER. No; that is fine.

Senator FANNIN. We certainly appreciate it. Thank you very much for your testimony.

Mr. HUFFAKER. Thank you very much.

[The prepared statement of Mr. Huffaker follows:]

## PREPARED STATEMENT OF JOHN B. HUFFAKER

I am John B. Huffaker, a partner in the law firm of Pepper, Hamilton & Scheetz. I have been deeply involved in matters relating to private foundations, both through the affairs of our clients, some of whom are members of the Council on Foundations, and as a member of various professional groups.

The minimum payout percentage for private foundations is fixed by the statute at 6% of corpus value for 1970 with special transition rules for existing foundations. It is my purpose to examine the mechanism in the statute for the year-to-year variations in the 6%, rather than engaging in the debate whether starting point is too high. My testimony will be concerned solely with the statutory provision for year-to-year adjustments in the minimum distribution requirement for private foundations. It seems to me that the statute possibly reaches a result contrary to Congressional policy, and one that threatens to irreparably damage the ability of foundations to meet their future obligations.

## A. CONGRESSIONAL INTENT

Section 4942 (e) (3) of the Code provides:

Applicable Percentage \* \* \* The applicable percentage for any taxable year beginning after 1970 shall be determined and published by the Secretary or his delegate and shall bear a relationship to 6 percent which the Secretary or his delegate determines to be comparable to the relationship which the money rates and investment yields for the calendar year immediately preceding the beginning of the taxable year bear to the money rates and investment yields for the calendar year 1969.

In order to test the validity of the formula in the statute, we must start with the purpose of the minimum payout rule.

A review of the statutory history shows a focus on fixing the percentage and a dearth of attention to the mechanics for adjusting it. The original 1965 Treasury Report (page 6) advocated: "An 'income equivalent' formally should be provided to place them [non-operating private foundations who would minimize their regular income by concentrating their investments in low yielding assets] on a parity with foundations having more diversified portfolios."

The percentage mentioned in the report is "in the range of three to three and one half percent." (Report, page 30.) Thus, at that stage the income equivalent was to avoid artificial levels of payout through investment in low yield stocks.

In the period between the 1965 report and the statement of Secretary Fowler on December 11, 1968 there had been some shift in this philosophy and the Secretary uses one example assuming a 5% equivalent. The Ways and Means Committee did adopt the 5% rule and its Report stated that the minimum payout rule is adopted "to prevent avoidance of the 'current—benefits—to—charity' rule proposed through investments in growth stock or non-productive assets." The report merely paraphrases the provision in the statute that the 5% rate is to be adjusted from time to time based upon money rate and investment yields. (Ways and Means Report, page 25.)

Before the Senate Finance Committee, Assistant Secretary Cohen stated that the 5% rule took into account long term appreciation and he recognized that 5% would require distribution of some amount of principal. (Senate Hearings, p. 677). He also pointed out that a different approach would have been to require distribution at the time gains were realized, but this would have inhibited the turnover of investments by foundations. He specifically stated that the rule "would not be a death sentence to a foundation;" also "it imposes some burden above what might be the recurring income \* \* \*". He recognized it would keep the foundations from "growing constantly" but made no mention of causing them to wither. The Finance Committee continued the provision in the House bill and the Finance Committee Report sheds no light on the year-to-year adjustment.

However, the Peterson Report (officially the Commission on Foundations and Private Philanthropy) had been received by the Committee and Senator Percy moved on the floor to increase the payout percentage from 5% to 6%. The Peterson Report contained statistical data showing that:

Current income + annual appreciation >6%

This analysis is somewhat suspect due to the base used. Table 1 attached indicates a better number would be about 4.5%. However, our attention is on the year-to-year adjustment.

In arguing for his amendment Senator Percy's key comment was. "The payout requirement should be high enough to require them [foundations] to invest their funds productively, but the percentage should not be so high as to amount to a delayed death sentence." In debate with Senator Curtis, Senator Percy stated that colleges do earn on their endowments "better than 6% including appreciation." See Cong. Record, Dec. 6, 1967 at p. 51595 et seq. The Peterson Commission Report is of particular importance in discerning intent because it is the only published rationale of how a payout percentage was determined. Over a period of years it determined the average ordinary income of mutual funds, the average per annum appreciation and reduced this total yield by the prevailing rate of inflation—1.6% to 2%.

#### *Conclusion Concerning Congressional Intent*

It appears evident that all legislative history includes a desire to require the distribution of an amount approximating true net income, i.e., the sum of current ordinary income plus appreciation less an adjustment for inflation of such amount was more than current income.

#### B. THE STATUTORY MECHANICS

The next step in the analysis is to compare the Congressional intent with the mechanics of Section 4942 (e) (3). As a starting point, let us consider the meaning of the terms "money rates" and "investment yields." The term "money rates" ordinarily refers to the interest rates that current loans will carry. The term "investment yields" probably can be read either as referring to current dividends or the total investment yield, i.e., ordinary income plus or minus capital appreciation less an adjustment for inflation. Thus far, the Treasury Department appears to have made the year-to-year adjustments by reference to current yields on new short term bond issues, but it has never published the formula that it is using.

We believe a persuasive case can be made that "investment yields" should be construed as "total investment yields;" however, there is a good case based on the literal reading of the statute that both terms should be read as referring to current yields. If we assume that the percentage change will be based upon changes in money rates (i.e., that the Treasury continues to follow the policy it appears to have followed thus far) then we have a dramatic increase in the 8% rate between 1973 and 1974. See Table 2.

By reference to the attached Table 1, it is noted that the Standard & Poor 500 stock index produces a yield before inflation adjustment in 1969 of 3.43% and in 1973 of 3.46%. The current stock market disaster now has the 500 stock index showing a yield of 5% (Table 2). Thus, we have an increase of an amazing 45%. This is one of the incidental impacts of the unforeseen and unprecedented inflation. As shown by Table 3, short term interest rates always follow inflation because a man will generally lend his money for a premium of 2% to 3% plus an amount to offset inflation. We have recently seen a prime rate of 12%, which reflects the predictable desire of lenders. Of course, the yield on common stock would also move in the same direction as the interest rates as common stocks compete with fixed return investments for the available funds. As we all know, stock prices have moved down and many stocks now sell at unprecedented levels in terms of earnings. Table 3 shows a greater stability in long term bond yields because the investor theoretically takes into account the anticipated inflation over the entire period that the bond is outstanding and therefore discounts what he regards as abnormal situations. Based solely upon the change in money and dividend yields the Treasury Department could justify a requirement for distribution for next year based on 1974 experience of 8½% or 9%.

It is noted that this approach completely ignores two of the three significant items that were taken into account in fixing the original minimum of 8%:

(a) Unrealized appreciation *increased* the amount that in 1969 Assistant Secretary Cohen visualized as being available for distribution whereas most investors experienced a significant capital *depreciation* during the current year;

(b) The inflation factor mentioned in the Peterson Report was in the 2% range, whereas the current rate is 12% or so; thus the formula might be construed to produce a required distribution of 9% with an invasion of principal (assuming a realization of the 5% current income yield) of 4%. Also, the portfolio probably suffered a loss in excess of 30% (again based upon changes in common stock indices).

Previously we summarized the Congressional interest as follows:

(1) Current income plus capital growth minus inflation loss equal minimum payout

(2) Minimum payout minus current income equal corpus invasion

Now in the statute capital appreciation and inflation loss are not expressly recognized as variables in the formula:

(1) Minimum payout equal corpus value multiplied by .06 multiplied by current rates and yields, divided by 1000 rates and yields

(2) Corpus invasion equal minimum payout minus current income

If we assume that the portfolio held its values, then there would still be a negative yield for the year, since the inflation exceeded the return on investments. This would seem to clearly indicate that the formula as construed in this manner reached the result contrary to Congress' intent.

While in the current climate it may seem an academic exercise, the application of the formula to a bull market produces the wrong result also. When the world is bright and gay and the investors optimistic, the yield on stock (as a percent of current value) tends to go down as the values go up. Stocks may sell for an average multiple of earnings of 16 or so as compared with a recession level of 8 or lower. This would reduce the 6%, since the current yield would have slipped from the 3.43% of 1969 to perhaps 3.0%. At the same time the stock market might be realizing a 30% appreciation, yet the foundations would only be required to distribute about 2% of corpus in excess of an average current yield. Thus only a small portion of the large real growth would be distributed.

#### CONCLUSION

If the statute is construed to fix the minimum current distribution level by reference to money rates and current yields on stocks then an absurd result threatening forced liquidation of foundation principal would be required next year. If the statute is construed to require reference to total current yield and the reference to money rates is construed to refer to an excess of interest over inflation, then Congress' intent would be effectively implemented, at least in the current market. This takes an interpretation that emphasizes Congressional intent—a possible result but certainly not an assured one. However, a year-by-year test would require distributions when capital appreciation is being generally realized although it is merely recouping capital losses in a prior year.

It should be noted that the 6% figure is applicable only when current income is below this figure. Thus when the true economic return of the foundation is a negative figure (or virtually so) by reason of inflation and capital depreciation, then the distribution would be based on the current income figure. There is no quarrel with a requirement of distributing current income currently but requirements for greater distributions should reflect bad years as well as good ones.

#### C. RECOMMENDATION

It is urged that the statute be clarified so that the Treasury Department will take into account true total yield for the year prior to the beginning of next year. It is an axiom that a statute should not be construed to reach an absurd result if another construction is possible. The Treasury Department might reach this result in any event, but the clarification would be an important immediate contribution to the orderly functioning of the private foundations.

However, even this will leave two severe problems:

(1) The 6% as a base is too high.

(2) The use of the percentage of corpus limitation on minimum distributions does not permit an offset of good results in one year by poor results in another.

Legislation similar to the bill (H.R. 11197) reported by Ways and Means in the last Congress would seem to be a simple way to get the time required to prevent irreparable harm while the problem receives the study it deserves. This bill substituted 5% for 6% and fixed percentages for the variable amount for a period of about 6 years.

## TABLES

TABLE 1.—True Yield on Common Stocks 1958-73 (prepared by Glenmede Trust Co.)

TABLE 2.—Current Yields on Various Stocks and Bonds (from Philadelphia Inquirer, November 18, 1974)

TABLE 3.—Graph Showing Relation of Interest Rates and Inflation (prepared by B. Zumeta, First Pennsylvania Banking &amp; Trust Co.)

TABLE 1

Year	Standard & Poor 500 year-end closing price (1)	Annual growth rate (percent) (2)	Standard & Poor 500 current yield (percent) (3)	Annual return (percent) (4)	Percent total year-end holding to beginning (5)	Annual inflation rate (percent) (6)	Annual loss due to inflation (percent) (7)	Net annual return (percent) (8)
1958	\$55.21	6.67	3.06	9.73	109.73	4.16	4.56	5.17
1959	58.89	-1.32	3.35	2.03	102.03	1.72	1.75	0.28
1960	71.55	23.13	2.82	25.95	125.95	1.23	1.55	24.40
1961	63.10	-11.81	3.38	-8.43	91.57	1.14	1.04	-9.47
1962	75.02	18.89	3.04	21.93	121.93	1.28	1.56	20.37
1963	84.74	12.96	2.95	15.91	115.91	1.56	1.81	14.10
1964	92.43	9.07	2.94	12.01	112.01	1.90	2.13	9.88
1965	80.33	-13.09	3.57	-9.52	90.48	2.80	2.53	-12.05
1966	96.47	20.09	3.03	23.12	123.12	3.14	3.87	19.25
1967	103.86	7.68	2.96	10.62	110.62	3.99	4.41	6.21
1968	92.06	-11.36	3.43	-7.93	92.07	4.88	4.49	-12.42
1969	92.15	.09	3.41	3.50	103.50	5.46	5.65	-2.15
1970	102.09	10.77	3.01	13.78	113.78	4.71	5.36	8.42
1971	118.05	15.63	2.67	18.30	118.30	3.15	3.73	14.57
1972	97.55	-17.37	3.46	-13.91	86.09	5.40	4.65	-18.56

Note: Average 4.53 percent.

TABLE 2.—CURRENT YIELDS

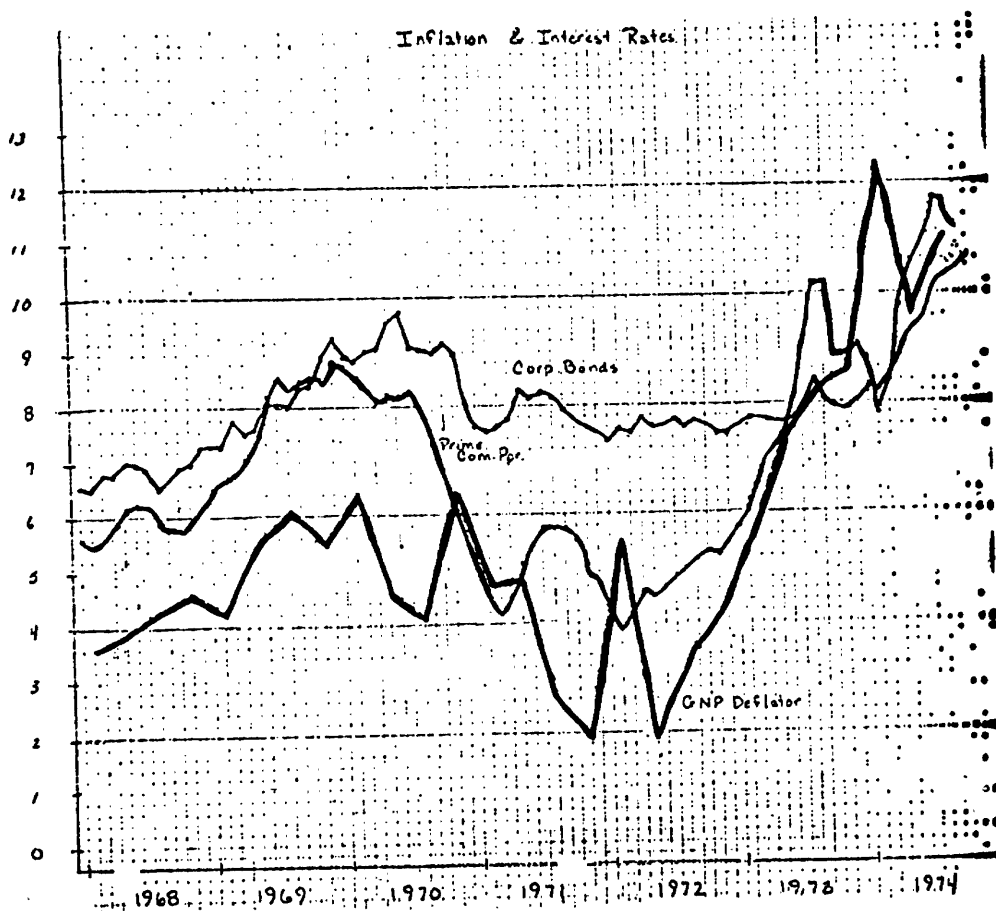
AVERAGE ANNUAL RETURNS CURRENTLY AVAILABLE ON INVESTMENTS IN VARIOUS GROUPS OF STOCKS AND BONDS

[In percent]

	Latest week	Previous week	Same week last year
<b>Standard &amp; Poor's stocks:</b>			
425 industrials	4.62	4.52	3.02
20 rails	6.23	6.15	5.05
55 utilities	9.95	9.92	7.11
500 composite	5.00	4.90	3.31
Preferred stocks	8.61	8.69	7.35
Philadelphia bank stocks <sup>1</sup>	7.38	7.21	3.87
<b>Standard &amp; Poor's bonds:</b>			
<b>AAA rated:</b>			
Industrials	8.36	8.28	7.63
Utilities	8.85	8.87	7.93
Composite	8.61	8.63	7.78
<b>AA rated:</b>			
Industrials	8.58	8.52	7.79
Rails	9.06	9.36	8.07
Utilities	9.10	9.12	8.08
Composite	8.91	9.00	7.98
<b>A rated:</b>			
Industrials	8.78	8.80	7.95
Rails	9.41	9.31	8.35
Utilities	9.23	9.25	8.29
Composite	9.15	9.12	8.20
<b>BBB rated:</b>			
Industrials	9.36	9.38	8.63
Rails	10.90	11.19	9.43
Utilities	9.61	9.63	8.49
Composite	9.96	10.07	8.69
<b>Government (taxable):</b>			
Long term	6.56	6.66	5.91
Intermediate term	7.46	7.57	6.92
Short term	7.64	7.78	7.20
Municipal: Municipal (high grade)	6.37	6.54	5.24

<sup>1</sup> Compiled by H. N. Nash Inc.





Senator FANNIN. The next witnesses will be Dr. Russell G. Mawby, Mr. William Baldwin, Robert Smith, and Lawrence Fox from the Ad Hoc Committee on Family Foundations.

So we can clarify, it was my understanding that Dr. Landrum Bolling of the Lilly Company Endowment was either filing his statement or is not here. Oh, he will be here tomorrow? All right, he will testify tomorrow.

Dr. Robert Bonine, Minnesota Council on Foundations, tomorrow?

Mr. BONINE. Yes, sir.

Senator FANNIN. All right.

And F. Lee Jacquette?

Mr. JACQUETTE. Yes. I would prefer today, if I might be heard after these gentlemen.

Senator FANNIN. All right, fine.

I just want to apologize. I did not know just exactly where we stood. I thought we were down to this Ad Hoc Committee, but we will hear you immediately after they complete their testimony.

Gentlemen, we welcome you here today, and apologize for the late hour, commend you for your patience, and you may proceed as you so desire.

**STATEMENTS OF H. LAWRENCE FOX, THE PEW MEMORIAL TRUST; ROBERT SMITH, THE PEW MEMORIAL TRUST; DR. RUSSELL G. MAWBY, PRESIDENT, THE KELLOGG FOUNDATION; AND JAMES W. RIDDELL, THE KELLOGG FOUNDATION**

Mr. Fox. We are grateful to be here.

Mr. Chairman, members of the subcommittee, I am H. Lawrence Fox, and I am acting as moderator for the following foundations who are represented by the Hormel Foundation, Raymond Ondov; the Kellogg Foundation, Dr. Mawby and James Riddell; the Kresge Foundation, William Baldwin—has left to catch a flight, I am sorry to say; the MacLellan Foundation; the Pew Memorial Trust, Robert Smith and myself; and the Woodruff Foundation.

For purposes of brevity, only four of our group will testify. However, all of us are available for answering questions.

Since our primary concern is with the economic impact of the minimum distribution rule, our testimony will be restricted to section 4942 of the code. However, we would like to state that we concur with the analysis and conclusion of your subcommittee that the excise tax in section 4940 should be reduced from 4 to 2 percent. Throughout our testimony, we will refer to your subcommittee report, which was dated October 4, 1974, as "the report."

Mr. Smith will testify on why section 4942 is operating to the detriment of private foundations. Dr. Mawby will illustrate the erratic application of that section, and Mr. Riddell will testify on the process for determining the applicable percentage in 4942(e)(3), and I will conclude our testimony.

The testimony being given is supported by a study entitled "The Impact of the Minimum Distribution Rule on Foundations" by Dr. Norman B. Ture,<sup>1</sup> which was a part of this group's testimony and statement before the House Committee on Ways and Means on April 10, 1974. That testimony and study, as well as detailed submission for this subcommittee, is submitted for incorporation into the record.

Senator FANNIN. The full testimony will be made a part of the record.

Mr. Fox. Thank you, sir. Our first speaker is Mr. Robert Smith.

**STATEMENT OF ROBERT SMITH, PEW MEMORIAL TRUST**

Mr. SMITH. Mr. Chairman, section 4942 requires private foundations to make annual distributions at a prescribed level, based upon endowment value. From our experience, this approach is not only unrealistic, but is forcing most private foundations to invade their corpus. The resulting decrease in endowment value, coupled with decreasing market values and double digit inflation, is detrimental to the future existence of private foundations. In addition to forcing an encroachment on capital, section 4942 does not give recognition to the fact that many private foundations that are currently able to support major charitable programs are only able to do so because their assets have been historically invested to provide a reasonable appreciation in value as well as

<sup>1</sup> See page 152.

a fair current return. Thus, the group is concerned with the method of determining such a distribution as set forth in section 4942, since it effectively prevents equity type investments. But the group is not philosophically opposed to the concept of a minimum annual charitable distribution.

Your subcommittee's statement that, "In our pluralistic society, we should never depend on Government alone to support research and innovation. Foundations offer an alternative to that dependence, and as such they should be welcomed and encouraged," is totally inconsistent with the operation of section 4942, which will bring about a slow but certain death sentence.

A 6 percent or higher rate is not realistic. Standard and Poors (1969) indicates that dividend paying stocks will pay less than an average of 4 percent in dividends. Using this as a measuring stick, most foundations will be forced to reduce principal assets. Obviously, a high distribution rate serves charity today, but also equally obviously, reduces charitable distributions for the next year and subsequent years by virtue of corpus shrinkage. In our statement to the House Committee on Ways and Means, we set forth several examples which showed that if a 6-percent annual payout requirement for foundations had been in effect since their creation, charitable distributions would have been greater than those actually made. However, because mandatory invasions of capital would have been required to meet the 6 percent standard during some of these years, the present value of the foundations' assets would have been reduced, with the result that current distributions would have been severely reduced. In other words, the present cost to charitable recipients would have been staggering. Even without considering the current inflation problem, if history repeats itself, the future of private foundations and their charitable recipients is bleak. This is totally contrary to the congressional intent, as indicated by the legislative history of section 4942. For example, in defending his amendment on the Senate floor, Senator Percy states: "The percentage should not be so high as to amount to a delayed death sentence."

From the legislative history, it is clear that section 4942 is premised upon a foundation's total rate of return being the sum of its dividends, interest and capital gain realized and unrealized, divided by the market value of the assets. The statutory formula may be stated as follows: current net income plus capital growth minus inflation equals proper distribution.

A simple example, applying this formula, illustrates why today the mandate may be a death sentence. Even assuming an unrealistically high current net income of 6 percent and a capital growth of 2 percent, and an inflation rate of only 8 percent, the application of this rationale shows that a zero distribution rate is appropriate—6 percent plus 2 minus 8 equaling the zero distribution. Obviously, the group is not desirous of an amendment requiring no distribution, but we wish to make it clear how unbalanced the statute is.

The failure of the statutory framework to include actual corpus growth and actual inflation, currently causes an automatic distribution in excess of current income which results in a corpus reduction. In addition, these results occur because the minimum investment return

rule is expressed as a fixed percentage of the fair market value of the assets held by a private foundation.

Often this fair market value is established by a public market, as in the case of common stocks of companies listed on a national stock exchange. In these instances, the traditional indication of value is the public's expectance of future earnings. Therefore, increased current earnings by the companies involved produce a proportionately greater increase in traded value, necessitating a greater invasion of principal to comply with the payout requirement, assuming no increase in dividends.

No matter how the problem is stated, under the 1969 Tax Reform Act, foundations must tap their capital resources for the difference between the required distribution rate of 6 percent and their actual cash income. This is unfortunate for foundations and bad for charity.

Mr. Fox. The next member of our group to testify is Dr. Russell Mawby, the president of the Kellogg Foundation, Battle Creek, Mich.

#### STATEMENT OF DR. RUSSELL G. MAWBY, PRESIDENT, KELLOGG FOUNDATION

Mr. MAWBY. Thank you, Mr. Chairman, Senator Curtis.

My remarks will describe the interrelationships of economics and philanthropy, as illustrated in the experience of one foundation. We think that our case represents very well that of hundreds of foundations across the country, though most of them are relatively small, grew out of a family-established business enterprise.

Because of the Kellogg Co. common stock held by the W. K. Kellogg Foundation Trust, the trust's market value since inception in 1935 has appreciated over tenfold, and has far exceeded the appreciation and income production which would have been realized if the assets had been in a 50-percent diversified portfolio, a 33½ percent diversified portfolio, or in an all-bond account.

From original gifts from our founder of \$45 million, which in 1973 had a fair market value of \$590 million, distributions to charity then totalled \$272 million; 1973 income from our continued holdings of Kellogg stock was 66 percent greater than in 1967, compared with an increase of only 12 percent from our diversified portfolio, and this favorable comparison continued in 1974.

Now, such a record of increasing philanthropic support could not have been achieved under the 6-percent minimum distribution rule of section 4942 in TRA 1969, since that rule mandates arbitrary and continuous invasions of corpus, which to us is an unsound practice in prudent fiscal management.

To illustrate, had the 6-percent distribution rule been in effect continuously since this Kellogg trust was established, the following would have occurred. First, from 1934 through 1974, the trust made an actual distribution of \$243 million. Had the minimum distribution rule been applicable, distributions of \$271 million—or an increase of \$28 million—would have been made. Second, to meet that payout requirement, the trust would have had to sell the equivalent of 18 million shares with a market value of \$201 million. Therefore, the trust's holdings would have been reduced to a market value of about \$206 million,

and thus in summary, the short-term higher return to charity of \$28 million would have cost \$201 million in corpus value, thereby reducing the current size of the trust by about 50 percent.

Further, for 1974-75, the distribution from the reduced assets would have been only \$10.9 million, rather than the \$21.7 million which will in fact be distributed. Thus, in addition to reducing the principal fund, the Tax Reform Act distribution provisions, had they been in effect, would have cut in half the income dollars available for distribution. Consequently, of course, the benefits of about half of the projects actually supported in recent years would never have been realized, and would have been lost forever, because it is unlikely there would have been any other source from which they could have been financed.

To illustrate this briefly in another way, if Congress had mandated the 6-percent payout, effective immediately, when the Tax Reform Act was passed in 1969, and therefore the full effect of the law had been in operation over the past 5 years, our corpus by now would have been reduced to the extent that this year's income would be reduced by \$1.9 million, or about 10 percent.

Now, in the current market situation, in spite of havoc being played on portfolios of mutual funds, pension funds, and endowments, the return to charity from our investment in Kellogg continues to increase, as evidenced by the fact that our gross income from Kellogg stock in the fiscal year just completed was 104 percent greater than just 10 years ago, having risen steadily each year. Further, the market value of our holding of Kellogg stock at October 31 was 42 percent greater than at December 31, 1969, and down only modestly—about 6½ percent—from last December 31. By comparison with that 6.5 percent decline, the decline in the Standard and Poor 500 stock index since last December 31 has been 24 percent, and the Dow Jones industrial average is down 21 percent. Mutual fund performance generally has been even worse. I would think that the efforts of some foundations to meet the high payout requirements of the law have no doubt resulted in an increase in portfolio risk taking to increase income. In the current economic decline, those kinds of investments have suffered the most, both from the decline in stock market values and from reduced or omitted dividends.

During the period 1965 through 1973, Kellogg Foundation grants increased an average of 7¼ percent per year. During that time, the annual erosion due to inflation averaged 3.9 percent. Thus, it can be seen that through prudent fiscal management and the distribution of all of its income to charity, the Kellogg Foundation has been able to more than counter the forces of inflation in its philanthropic endeavors. Specifically, its annual grants outpaced inflation through 1973 by an average of over 3 percent per year. However, because of Federal wage and price controls which limited dividends, Kellogg Foundation grants in 1974 were only 3.8 percent greater than in 1973. To have kept up, of course, with the double digit inflation during 1974 would have required massive invasions of corpus.

In 1975, we expect continued improved earnings from our Kellogg holdings, to the extent that our 1975 return to charity will be over \$23 million—after excise taxes—or 5½ percent greater than in 1974. And throughout this period, and in spite of increasing administrative costs caused most foundations by the Tax Reform Act and by inflation,

Kellogg Foundation administrative costs have been held to under 5 percent, thus further maximizing our return to charity.

Looking at the current economic crisis of our grantees, accurate statistics are not yet available reflecting cost increases in the educational and health sector. However, when the 1975 increase of 5½ percent in Kellogg Foundation grants is contrasted to the double digit inflation figure of 10 to 12½ percent for the economy in general, it is apparent that we will not now be able to provide charitable funding either to counter or exceed the general level of inflation, let alone the even greater cost increases being experienced in the nonprofit sector.

Even so, the picture would have been far worse if the Tax Reform Act distribution and investment provisions had been in full operation in recent years, resulting in deep cuts in principal, and therefore the income available for distribution to charity.

Under the current law, the time will very soon come when drastic erosions of our foundation's corpus will be necessary. Recent history, from the experience of those foundations which have consistently invaded corpus for payout purposes, has proved that such continuous invasions, in either bull or bear markets, will drastically erode the continuing capacity of foundations to carry on their philanthropic activities. It is therefore apparent that if private foundations are to be a continuing and vital part of our society's approach to its problems, a change in this provision of the law must be made.

Mr. Fox. The next member of our group to testify will be Mr. James Riddell, the Washington counsel for Kellogg.

#### STATEMENT OF JAMES W. RIDDELL, KELLOGG FOUNDATION

Mr. RIDDELL. Under section 4942(e)(3), the Secretary of the Treasury is authorized to establish the applicable percentage in determining the minimum investment return. The Treasury last exercised this power on April 24, 1974, in T.I.R. No. 1288. While no public information has been made available as to what information the Treasury utilized in determining the appropriate rate, it is our understanding that it was based upon U.S. Treasury intermediate obligations. The statute mandates that the Secretary consider "money rates and investment yields." Based upon the legislative history, it must be assumed that investment yields is the equivalent of dividend yields. In this connection, the report's conclusion that "the adoption of a reasonable standard in the case of section 4942 would seem both appropriate and wise" is wholeheartedly endorsed.

Moreover, in light of the fact that time may not permit legislative relief this year, it would be appropriate for the Committee on Finance of the Senate to direct the Secretary to include investment yields as well as interest rates in its calculations for section 4942(e)(3). In fact it would be appropriate for this subcommittee and the Committee on Finance to direct the Secretary to take into account the full formula as expressed in the complete legislative history of the statute, Senators, and to make the formula turn on current net income, plus capital growth, minus inflation, and that would give us a proper distribution figure which we could all live with.

The report also recommended that 4942 be amended to give the public opportunity to comment on proposed changes in the applicable

percentage. We obviously endorse this recommendation but also would like to point out to the committee that the Secretary, without legislation, could propose the standards to be applied by regulation and give the public an opportunity to comment by promulgating such rules in a notice of proposed rulemaking.

I will now give you back to Larry Fox.

#### STATEMENT OF H. LAWRENCE FOX, PEW MEMORIAL TRUST

Mr. Fox. Because of the effective date provision of the Tax Reform Act, we feel the Congress must make an attempt to amend section 4942 this year. If not, private foundations may be faced with the minimum investment percentage of 8 percent or more by 1975, particularly if the action called for by Mr. Riddell is not taken. In addition to your subcommittee's statement indicating the need for a reexamination of the operation of section 4942, the Committee on Ways and Means, with Treasury concurrence, has proposed specific amendments.

H.R. 11197 was previously discussed by Mr. Huffaker, and therefore I will not make any note of that bill other than to again emphasize that a similar bill, S. 3927, has been introduced by Senator Curtis in this Congress.

On September 23, 1974, the Committee on Ways and Means tentatively decided that for a 5-year period beginning December 31, 1973, the private foundations' charitable expenditure rules would be modified so that a foundation would not be required to reduce its endowment below the value on December 31, 1970. However, this rule did not reduce the expenditure requirement below the greater of 4 percent or the value of the endowment or the foundation's income for the year.

Such an amendment has merit in that it recognizes that there are inequities with the application of section 4942, but provides absolutely no substantive relief to this group by virtue of the valuation date or freeze base, being December 31, 1970.

The following example illustrates this type of an amendment. Assume that private foundation A and private foundation B each have an endowment value of \$100 million on December 31, 1970. On December 31, 1975, A's value is still \$100 million and B's is \$150 million. Further assume that A's income for 1975 is \$4½ million and B's is \$6¾ million.

Applying the amendment, both A and B have a freeze base of \$100 million. Since the application of section 4942(e)(3) would cause A to fall below its freeze base, it would be required to pay out the greater of its income or 4 percent of the freeze base. Thus, the amendment protects A's endowment, not including any shrinkage due to inflation. In B's case, the application of 4942(e)(3) would not cause it to fall below its freeze base and, accordingly, it would have to pay out the full \$10½ million, which would result in an endowment loss of \$3¾ million plus inflation.

In brief, a freeze base amendment is welcomed because it indicates that the Treasury and the Committee on Ways and Means recognize that section 4942 must be amended. However, if this type of an amendment is enacted, it must be modified. The example amply illustrates this point, that is, foundation A, whose endowment remains stable, has properly benefited, whereas B, whose endowment value had risen, was not. In fact B would be forced to divest assets even though it may be

assumed that its endowment from charitable distributions steadily increased over the years.

A refinement of the freeze base, if it is possible to have legislation in the near future, would be to have a moving annualized base. That is, instead of a constant endowment value, after December 31, 1970, the base for each year should be the endowment value as of December 31 of the previous year. This concept may be illustrated with the prior example except that A's December 31, 1974 endowment value is \$100 million and B's is \$148 million. For A the result would be the same as the previous example. However, for B the minimum distribution would be its income of \$6.75 million.

After almost 5 years there has been time to examine how section 4942 will operate to undermine overall foundation grants, and an opportunity to further examine some of the assumptions of the Peterson report. For this purpose, as we mentioned earlier, we have had an independent study prepared by Dr. Norman Ture. The findings and conclusions of that report, as briefly summarized, are first, the minimum distribution rule may possibly have a capricious impact on foundations and on their long-term capacity to support charities.

Second, the investment performance of foundations is not poor.

Third, there is no sound evidence to support the view that the allegedly poor investment performance of foundations is related to the concentration of the investment assets.

Fourth, a minimum distribution rule will not result in significant increases in the rate of return on foundation investments.

Finally, the tax savings allegedly realized by those establishing foundations are, in all likelihood, every small. In addition, foundation distributions to charity have represented a sizeable amount of benefits relative to the foregone revenues.

From all of the foregoing, three things are apparent: The underlying premise of a 6-percent minimum distribution was predicated upon false assumptions; the statutory formula forces endowment shrinkage which operates to the detriment of charity; this rule must be changed.

The requirement of distributions to charity at a fixed or variable rate of 6 percent of the current market value of the foundation's assets, confront foundation managers with difficult decisions that do not necessarily relate to the well-being of charity. For example, many foundations hold all or substantial portions of the original gifts from their founders. This is often consistent with the founders' expressed desires, and more importantly, the long-term performance of the donated holdings of justified continued retention rather than venturing into unknown territory through diversification.

If section 4942 is not amended, the effectiveness of all foundations will be eliminated to the detriment of charity. This position is amply supported by the group's accomplishments and experience as well as by the Ture study which indicates that private foundations can give a better return per dollar to charity than the Federal Government.

Our conclusion that section 4942 must be revised is not inconsistent with our opening statement that private foundations have a moral and should have a legal obligation to make minimum annual charitable distributions. After all, that is their function. The group merely



wishes to insure that they will exist in the future so that they will have such a function.

Thank you.

Senator CURTIS. Mr. Chairman, I think these gentlemen have made the case very clear. There are a number of ideas that might be stressed by questioning, but due to the lateness of the hour and other witnesses to be heard, I think I shall pass.

Senator FANNIN. Thank you, Senator Curtis.

The only question I would ask would pertain to some of the other members of the committee and some of the members of this subcommittee have recommended that the Standard and Poor's other averages be used when setting the minimum distribution level.

Do you think that the use of averages such as Standard and Poor is a good way of setting a standard for foundations assist performance?

Mr. Fox. I think that certainly would be more appropriate than what we now have.

Senator FANNIN. Would you like to elaborate?

Dr. MAWBY. Well, it would seem to me, Mr. Chairman, that that is a much more realistic reflection of market performance and therefore is a realistic standard which might be used in setting minimum distribution requirements.

Senator FANNIN. Well, thank you. If you are all in agreement—

Mr. SMITH. I would concur with that also, Mr. Chairman.

Senator FANNIN. Well, thank you very much, but do you think there is any way short of amending the statute that Congress could make clear its intent that the impact of inflation be taken into account when setting the minimum distribution level?

Mr. RIDDELL. Yes, Senator, I think that it could. As I stated, I think it is within the power of this committee, this subcommittee and the full committee, to instruct the Joint Committee on Internal Revenue Taxation to draw attention to the Treasury Department of the legislative history of the 1969 act which, after all, was fully stated in the reports of this committee, of the conference committee of the two legislative bodies and the floor debates which were very, very full on the subject and which make it clear that in addition to interest rates, that investment return and inflation should be taken into account.

Now I have not seen the letter alluded to here earlier by Mr. Huffaker in which it is stated that Assistant Secretary Hickman of the Treasury Department has informed Mr. Hartke, the Senator from Indiana and chairman of this subcommittee, that it will, under its present plans, issue a statement next year stating that the minimum investment return is 7 percent.

Mr. Fox. Or higher.

Mr. RIDDELL. Excuse me? Seven percent or higher, and it will relate only and rely only upon the then rate at which intermediate Treasury obligations are selling.

So I believe that even if you do not have time to address the problem legislatively, you still have the opportunity to make known the will and sense of the Senate and of the Congress through the Joint Committee staff, and that the Treasury Department has adequate opportunity to act to ameliorate this situation even though you do not have time to address yourself to it legislatively.

Senator FANNIN. Thank you.

Just one further question tonight. You say that the minimum distribution rule must be changed by Congress this year but will a new rate be set by Treasury before next spring?

Mr. RIDDELL. Yes.

Senator FANNIN. Then why must we act now?

Mr. RIDDELL. Because of the method that the Treasury Department is utilizing. It will be so hard that it is going to cause irreparable harm to many foundations, including all of the foundations represented here.

Mr. Fox. To this date Treasury has not gone over 6 percent because of the transition rules provided in the Tax Reform Act. But starting next year, then the full 6 percent or a variable rate goes into effect and that is why we said legislation this year, and that is why our concern that if the Treasury is not brought to address itself to the facts of life, if you will, to what is happening in this country, we will be irreparably harmed.

For example, a foundation must make its determination or guess as to what it will be paying out and then it will encourage that many recipients come in and ask for grants. So that if the Treasury came in with a lower percentage, I do not believe that any of the foundations here would cut back on those grants, and therefore, they would have that reduction in corpus that we so greatly fear.

Senator FANNIN. Thank you kindly. We certainly do not want to cut down on any testimony that we would like to get, so if you have further information that you would like to furnish to the committee in writing, we would appreciate receiving it from you.

I want to express the appreciation of the committee for your patient understanding and for your very valuable contribution.

Thank you, gentlemen.

Mr. Fox. Thank you very much.

Mr. RIDDELL. Thank you.

[The prepared statement of Mr. Fox with attachments follows. Hearing continues on p. 162.]

PREPARED STATEMENT BY H. LAWRENCE FOX, ON BEHALF OF THE HORMEL FOUNDATION, THE KELLOGG FOUNDATION, THE KRESGE FOUNDATION, THE MACLELLAN FOUNDATION, THE PEW MEMORIAL TRUST, THE WOODRUFF FOUNDATION, ON THE IMPACT OF THE CURRENT ECONOMIC CRISIS OF THE MINIMUM DISTRIBUTION RULE (SECTION 4942 OF THE INTERNAL REVENUE CODE OF 1954) ON FOUNDATIONS

## Summary

### I. INTRODUCTION

On April 10, 1974, the Group testified before the House Committee on Ways and Means. That testimony, written statement and a study by Dr. Norman B. Ture are a part of this presentation. We support the action taken by the Congress in the Tax Reform Act of 1969 to eliminate certain abuses previously associated with certain foundations, but two of the rules adopted in 1969 unduly restrict legitimate foundation activities and, accordingly, we urge that they be reexamined and changed—the 4 percent excise tax, and the requirement that the annual distributions of private foundations must be at least equal to a certain percentage of the current value of their investment assets (hereinafter referred to as the "minimum distribution rule").

#### A. Section 4940, 4 percent excise tax

We concur with the analysis and conclusion of the Statement of the Finance Subcommittee on Foundations (hereinafter "The Report"), dated October 4, 1974, that "... the load of the excise tax should be reduced from 4 to 2 percent."

### *B. Section 4942, the minimum distribution requirement*

Section 4942 was not intended to be detrimental to the future existence of private foundations; but it is because it is forcing most private foundations to invade their corpus; this decrease when coupled with decreasing market values and double digit inflation will eventually eliminate private foundations. In addition, Section 4942 does not give recognition to the fact that many private foundations that are currently able to support major charitable programs are only able to do so because their assets have been historically invested to provide a reasonable appreciation in value as well as a fair current return.

In brief the Group is concerned that one, Section 4942 effectively prevents equity type investments; two, the 6 percent rate set forth in Section 4942(e) (3) is too high, and three, the method for determining the applicable percentage by the Treasury has to be amplified. Notwithstanding these comments, the Group is not philosophically opposed to the concept of a minimum annual charitable distribution.

### *C. Foundations are important to America*

We hardly endorse the Report's conclusion that "... we should never depend on government alone to support research and innovation. Foundations offer an alternative to that dependence and—as such—they should be welcomed and encouraged." This conclusion is totally inconsistent with the operation of Section 4942, i.e., a slow but certain death sentence.

## II. THE SUBSTANTIVE PROVISIONS OF SECTION 4942

### *A. In general*

A 6 percent or higher rate is not realistic. Standard & Poors indicates that dividend paying stocks will pay less than an average of 4 percent in dividends. A high distribution rate serves charity today but also obviously reduces charitable distribution for the future by virtue of corpus shrinkage. If a 6 percent annual payout requirement had been in effect since the creation of our Group, charitable distributions would have been greater than those actually made, but because mandatory invasions of capital would have been required to meet the 6 percent standard during some of these years, the present value of the Foundations' assets would have been reduced with the result that current distributions would have been severely reduced. If history repeats itself, the future of private foundations and their charitable recipients is bleak. See Written Statement for illustrative example.

### *B. Legislative history*

#### *1. In general*

The legislative history of Section 4942 makes it absolutely clear that the intent behind the development of a minimum distribution rule was not to require foundations to diminish their endowment as it clearly requires.

#### *2. Statute ignores inflationary impact*

Section 4942 is premised upon a foundation's total rate of return being the sum of its dividends, interest and capital gain realized and unrealized, divided by the market value of the assets. The statutory formula is as follows:

$$\text{Current net income} + \text{capital growth} - \text{inflation} = \text{proper distribution}$$

Even assuming an unrealistically high current net income of 6 percent and a capital growth of 2 percent, and inflation rate of only 8 percent, the application of this rationale shows that a zero distribution rate is appropriate ( $6\% + 2 - 8 = 0$  distribution). Obviously, the Group is not desirous of an amendment requiring no distributions to charity, but we wish to make it clear why the statute is a death sentence.

The failure of the statutory framework to include actual corpus growth and actual inflation, currently causes an automatic distribution in excess of current income which results in a corpus reduction. In addition, these results occur because the minimum investment return rule is expressed as a fixed percentage of the fair market value of the assets held by a private foundation.

### *3. The Statute, Contrary to Legislative Intent, May Force Private Foundations to Eliminate Equity Investments*

Besides the formula not taking into account inflation and capital growth, it is illogical because there is no general rule to correlate stock prices and earnings

Increased current earnings by the companies involved produce a proportionately greater increase in traded value, necessitating a greater invasion of principal to comply with the payout requirement. The Written Statement contains an example which illustrates these points.

### *C. Legislative Consideration to Correct Section 4942*

In addition to The Report recognizing the need for a reexamination of the operation of Section 4942, the House Committee on Ways and Means, with Treasury concurrence, has proposed specific amendments:

#### *1. H.R. 11197—unanimously reported out by the Ways and Means Committee in the 92nd Congress*

It would have reduced the income equivalent for foundations from six to five percent and provided certain transition rules to allow foundations the opportunity to adjust Section 4942 (a minimum distribution of three and one-half percent for 1972 and 1973, four percent for 1974 and 1975, four and one-half percent for 1976 and 1977 and a five percent ceiling thereafter). Its substantive provisions were the result of coordination with the Treasury. A similar Bill, S. 3927, has been introduced by Senator Carl Curtis (R. Nebr.) in this Congress.

#### *2. Tax Reform Bill of 1974*

On September 23, 1974, the Committee on Ways and Means tentatively decided that for a 5-year period beginning December 31, 1973, private foundation charitable expenditure rules in Section 4942 would be modified so that a foundation would not be required to reduce the value of its endowment below the value on December 31, 1970; however, this rule would not reduce the charitable expenditure requirement below the greater of (1) 4 percent of the value of the endowment or (2) the foundation's income for the year. Such an amendment (hereinafter referred to as the "freeze base amendment"), has merit in that it recognizes that there are inequities with the application of Section 4942, but provides no substantive relief to this Group by virtue of the valuation date or freeze base being December 31, 1970. See Written Statement for valuations. Also the Written Statement contains an example which illustrates the application of the freeze base amendment to Section 4942.

In brief the freeze base amendment is welcomed because it indicates that the Treasury and the Committee on Ways and Means recognizes that Section 4942 must be amended. However, if this type of amendment is enacted, it must be modified, otherwise the same problems that exist with the statute as enacted in 1969 will continue to exist.

#### *3. Action Which Should and Must Be Taken*

*a. Legislative.*—In order to prevent irreparable harm to the nation's charitable institutions' grant-making policy, the Committee on Senate Finance should favorably consider taking immediate action on amending Section 4942 (this year).

Since both the staffs of the Treasury and the Joint Committee have worked on the development of the freeze base concept subsequent to H.R. 11197, it is logical to assume that this concept is appropriate for immediate consideration by the Committee. However, it must be further developed.

A refinement of the freeze base concept would be to have a moving annualized base, i.e., instead of a constant endowment value as of December 31, 1970, the base for each year should be the endowment value as of December 31 of the previous year. The Written Statement contains an illustrative example.

Another alternative to the freeze base as proposed by the Committee on Ways and Means would be to use the December 31, 1970 base adjusted upwards by inflation or the May 26, 1969 valuation adjusted upwards by inflation.

With any of the foregoing refinements, the concept applies fairly to all private foundations. Obviously, such an amendment would be a step toward the elimination of the slow unintended death of private foundations due to the statutory deficiencies previously set forth.

*b. Administrative.*—Under Section 4942(e) (3) the Secretary of the Treasury is authorized to establish the applicable percentage in determining the minimum investment return. In this connection, The Report's conclusion that "The

adoption of a reasonable standard in the case of Section 4942 would seem both appropriate and wise," is wholeheartedly endorsed.

*D. Other problems related to Section 4942*

*1. Donative Intent*

In addition to the sound economics associated with owning securities, the trustees may be required to take actions contrary to the desires of the donors as expressed in original trust documents if they divested stock from corpus. As long as these provisions were legal when drawn, done in good faith, in the interest of charity, and provide for prompt payout of cash income, we believe they should prevail and not be subject to change after the program is underway.

Incidentally, the Group takes pride in pointing out to the Subcommittee that their performance has outdistanced those private foundations who diversified their portfolios rather than remaining in stock ownership in a few companies.

*2. Management Difficulties Caused by 1969 Rules*

The monthly valuation requirement consumes time and attention that is non-productive of charitable benefit. Foundation managers are forced to be concerned with short-term market trends rather than with basic soundness of an investment.

Second—and probably more important—is the problem associated with handling grants and fluctuating market values.

*E. Diversification: Not the answer, case in point*

From the foregoing discussion, it should be clear that the inequities of Section 4942 are not eliminated by virtue of a private foundation diversifying its portfolio.

*F. True economic study*

The Written Statement contains a brief summary of the Ture study which focuses on some of the inaccuracies of the Peterson Report and how improperly Section 4942 operates.

**Conclusion**

From the foregoing, three things are apparent: One, the underlying premise of the 6 percent minimum distribution rule is predicated upon false assumptions; two, the statutory formula forces endowment shrinkage which operates to the future detriment of charity; and three, this rule must be changed if private foundations are to continue to be permitted to serve their function in the support of charitable undertakings.

The requirement of distributions to charity at a fixed or variable rate of 6 percent of the current market value of the foundation's assets, confronts foundation managers with difficult decisions that do not necessarily relate to the well being of charity.

If Section 4942 is not amended, it is clear that the principles set forth in the Peterson Report and incorporated in Section 4942 will impair the effectiveness of all foundations and eliminate many of them to the detriment of charity. This position is not only supported by the Group's accomplishments and experience, but by the Ture study which indicates that private foundations can give better return per dollar to charity than the Federal Government. No one has suggested increasing the Government's role in advancing philanthropy, which is precisely what must happen if Section 4942 is not revised.

Our conclusion that Section 4942 must be revised is not inconsistent with our opening statement that private foundations have a moral and should have a legal obligation to make minimum annual charitable distributions; that is their function. The Group merely wishes to insure that they will exist in the future so that they will have such a function.

**Statement**

**I. INTRODUCTION**

On April 10, 1974, this Group, the Hormel Foundation, W. K. Kellogg Foundation, Kresge Foundation, Lilly Endowment, Inc.<sup>1</sup>, Maclellan Foundation, Pew

<sup>1</sup> The Lilly Endowment, Inc. concurs in this statement, but will testify individually and file a separate statement.

Memorial Trust and the Woodruff Foundation, testified before the House Committee on Ways and Means. Copies of our testimony, written statement and a study by Dr. Norman B. Ture have already been submitted to this Subcommittee. For purposes of convenience, they are attached hereto and made a part of this presentation. Accordingly, we will only summarize portions of the foregoing presentation. At that time we indicated that as a Group we support the action taken by the Congress in the Tax Reform Act of 1969 to eliminate certain abuses previously associated with certain foundations. And, we strongly endorse the efforts of Congress to assure that Foundations operate properly in the public interest. We continue to recognize that the abuses of some Foundations necessitated corrective action, both to provide safeguards against the recurrence of those abuses and also to reassure the public that continued tax exemption for foundations would serve the national interest. On the other hand, we are concerned that correction of such abuses through undue and unnecessary restrictions might well be a disservice to that public interest if legitimate foundation operations are curtailed thereby.

We are concerned with the fact that two of the rules adopted in 1969 unduly restrict legitimate foundation activities and, accordingly, urge that each of them be reexamined and changed. The first rule is the imposition of the 4 percent excise tax on net investment income of private foundations, and the second is the requirement that the annual distributions of private foundations must be at least equal to a certain percentage of the current value of their investment assets (hereinafter referred to as the "minimum distribution rule"). These two rules are directly related to three issues raised by Chairman Hartke: 1) the impact which the current economic crisis is having on the Group; 2) the impact it has had on charitable recipients; and 3) the impact it is likely to have on charitable recipients.

*A. Section 4940, 4% excise tax*

We concur with the analysis and conclusion of the Statement of the Finance Subcommittee on Foundations, together with additional views, (hereinafter "The Report") by Chairman Vance Hartke (D. Ind.), October 4, 1974, that ". . . the load of the excise tax should be reduced from 4 to 2 percent." Accordingly, no further comments will be made in this statement other than to emphasize the fact that such a reduction would automatically increase private foundations' grants to charitable recipients.

*B. Section 4942, the minimum distribution requirement*

The primary goal of this statement is to make it clear that the statutory requirement that private foundations pay out a fixed percentage of their investment assets each year in pursuit of their charitable activities is detrimental to the future existence of private foundations; without a doubt this was not the intended purpose of Section 4942. The rationale behind this novel concept was apparently one, to insure that current distributions were sufficient to justify any tax-benefit donors might receive from their contributions, and two, to prevent private foundations from growing indirectly by investing in the stock of companies which retained most of their earnings and thereby delaying indefinitely charitable expenditures commensurate with the value of their assets. To satisfy both of these requirements, Section 4942 requires private foundations to make annual distributions at a prescribed level. From our experience, this approach is not only unrealistic but is forcing most private foundations to invade their corpus. The resulting decrease in endowment value, coupled with decreasing market values and double digit inflation will eventually eliminate private foundations. Obviously, the Group recognizes that the Committee cannot directly control inflation or stock values, but it can amend Section 4942.

In addition to forcing an encroachment on capital, Section 4942 does not give recognition to the fact that many private foundations that are currently able to support major charitable programs are only able to do so because their assets have been historically invested to provide a reasonable appreciation in value as well as a fair current return. Thus, the Group is concerned with the method of determining such a distribution as set forth in Section 4942 since it effectively prevents equity type investments, and even if that method of determination were acceptable, the 6 percent rate set forth in Section 4942(e) (3) must be reduced. Assuming the latter is not accomplished, the method for determining the appli-

cable percentage by the Treasury has to be amplified. In brief, this Group knows that Section 4942 as enacted in 1969 is detrimental to charity and the well being of this nation but is not philosophically opposed to the concept of a minimum annual charitable distribution.

### *C. Foundations are important to America*

We hardly endorse The Report's conclusion that "In our pluralistic society, we should never depend on government alone to support research and innovation. Foundations offer an alternative to that dependence and—as such—they should be welcomed and encouraged." (The accuracy of the statement is underscored by the national economic picture where the Federal Government is in the posture of having to reduce its expenditures in this area. Thus the need for and burden of private foundations in the nation continues to grow.) This conclusion is totally inconsistent with the operation of Section 4942, i.e., a slow but certain death sentence.

Section 4942 is a part of Chapter 42 of the Tax Reform Act of 1969 which appears to have promulgated a new and unhealthy concept in regard to private foundations. Instead of regarding those who had transferred their funds to a charitable trust as persons to be held in public esteem, the attitude seemed to be that these persons were probably up to nefarious tax schemes warranting elaborate safeguards. The implication somehow was that the Treasury was being cheated, notwithstanding the beneficial role private foundations play in society.

## II. THE SUBSTANTIVE PROVISIONS OF SECTION 4942

### *A. In general*

A 6 percent or higher rate is not realistic. Standard & Poors indicates that dividend paying stocks will pay less than an average of 4 percent in dividends. Using this as a measuring stick, most foundations will be forced to reduce principal assets. Obviously, a high distribution rate serves charity today but also obviously reduces charitable distribution for the next year and subsequent years by virtue of corpus shrinkage. In our statement to the House Committee on Ways and Means, we set forth several examples which showed that if a 6 percent annual payout requirement had been in effect since their creation, charitable distributions would have been greater than those actually made, but because mandatory invasions of capital would have been required to meet the 6 percent standard during some of these years, the present value of the Foundations' assets would have been reduced with the result that current distributions would have been severely reduced.<sup>2</sup> In other words, the present cost to charitable recipients would have been staggering. Even without considering the current inflations problem to be discussed, if history repeats itself, the future of private foundations and their charitable recipients is bleak.

### *B. Legislative history*

#### *1. In General*

The legislative history of Section 4942 is amply set forth in The Report and our testimony before the Committee on Ways and Means. Both make it absolutely clear that the intent behind the development of a minimum distribution rule was not to require foundations to have such a high charitable distribution rate that it would be necessary for them to diminish their endowment as Section 4942 clearly requires. For example, in defending his amendment on the Senate floor,<sup>3</sup> Senator Percy states: "The payment requirement should be high enough to require private foundations to invest their funds productively. *The percentage should not be so high as to amount to a delayed death sentence.*" [emphasis added]

#### *2. Statute Ignores Inflationary Impact*

From the legislative history, it is clear that Section 4942 is premised upon a foundation's total rate of return being the sum of its dividends, interest and

<sup>2</sup> See Exhibit A for revised figures of the W. K. Kellogg Foundation which is illustrative of the Group.

<sup>3</sup> Congressional Record of December 6, 1969, at Pages S15959 through S15964.

capital gain realized and unrealized, divided by the market value of the assets. The formula is as follows:

Current net income + capital growth—Inflation=proper distribution

Assuming dividend or interest income of 4 percent, capital growth at 6 percent and inflation at 2 percent or less, the statute mandates that a private foundation's minimum distribution should be 6 percent or more without an erosion of corpus. A simple example, applying this formula, illustrates why today the mandate may be a death sentence for private foundations. Even assuming an unrealistically high current net income of 6 percent and a capital growth of 2 percent, and an inflation rate of only 8 percent, and application of this rationale shows that a zero distribution rate is appropriate ( $6\% + 2 - 8 = 0$  distribution). Obviously, the Group is not desirous of an amendment requiring no distribution to charity, but we wish to make it clear how unbalanced the statute is.

From the foregoing, it is readily apparent that when the formula is applied in conjunction with the 6 percent or higher percentage called for in Section 4042(e)(3), along with little or no capital appreciation and 4 percent current income, there will be a corpus reduction in direct relationship to the applicable percentage. (Note that this example illustrates that the statutory formula unrealistically reduces corpus growth and inflation to constants.)

The failure of the statutory framework to include actual corpus growth and actual inflation, currently causes an automatic distribution in excess of current income which results in a corpus reduction. In addition, these results occur because the minimum investment return rule is expressed as a fixed percentage of the fair market value of the assets held by a private foundation.

### *3. The Statute, Contrary to Legislative Intent, May Force Private Foundations to Eliminate Equity Investment*

Besides the formula not taking into account inflation and capital growth, it is illogical because there is no general rule to correlate stock prices and earnings. Often this fair market value is established by a public market, as in the case of common stocks of companies listed on a national stock exchange. In these instances, the traditional indicia of value is the public's expectancy of future earnings. Therefore, increased current earnings by the companies involved produce a proportionately greater increase in traded value, necessitating a greater invasion of principal to comply with the payout requirement. In addition to stocks being valued upon the basis of earnings, dividend policies require companies, if they are to grow and remain financially sound, to limit their dividend distributions to a maximum of 50-60 percent of earnings. Many companies, such as the extractive industries, are forced to retain larger portions of earnings to underwrite exploration and development programs. Likewise, other groups, faced with constant heavy drains for research and development costs, must limit their dividend payments to small percentages of annual earnings in order to provide funds for expanding operations. Thus, many sound companies simply cannot pay out enough dividends to support a 6 percent or higher payment.

This point may be again illustrated by the following example: Assume a stock earns \$5 per share. It would sell at about \$75 with a multiple of 15. If it paid 60 percent of its earnings as dividends, the dividend would be \$3 or 4 percent (a little higher than normal) which would still not provide enough income to allow a minimum distribution of 6 percent or more without a corpus reduction. Hopefully, this example should help to make it clear that it is irrational to have a general rule requiring payments based on current values that in no way reflect current earnings.

The irony of this situation is readily apparent. Private foundations are now forced to sell sound income-producing common stocks held over a long period of time only because the investing public places a high value on those same shares for future appreciation potential. If the rule continues, private foundations will be foreclosed from investments in marketable securities which would be illogical and detrimental to the long range responsibility of these foundations. (For example, The Report notes that private foundations will have equity investments.)

No matter how the problem is stated, under the 1969 Tax Reform Act, foundations must tap their capital resources for the difference between the required distribution rate of 6 percent and their actual cash income. This is unfortunate for foundations and bad for charity.



*C. Legislative Consideration to Correct Section 4942*

In addition to The Report recognizing the need for a reexamination of the operation of Section 4942, the House Committee on Ways and Means, with Treasury concurrence, has proposed specific amendments:

*1. H.R. 11197*

This bill was unanimously reported out by the Ways and Means Committee in the 92nd Congress. However, no tax bills were enacted by that Congress. It would have reduced the income equivalent for foundations from six to five percent and provided certain transition rules to allow foundations the opportunity to adjust to Section 4942 (a minimum distribution of three and one-half percent for 1972 and 1973, four percent for 1974 and 1975, four and one-half percent for 1976 and 1977 and a five percent ceiling thereafter). Its substantive provisions were the result of coordination with the Treasury.

Enactment of this Bill would have reduced the impact of corpus invasion by lowering the applicable percentage, but would not have corrected all of the other problems with Section 4942 as set forth herein. A similar Bill, S. 3927, has been introduced by Senator Carl Curtis (R. Neb.) in this Congress.

*2. Tax Reform Bill of 1974*

On September 23, 1974, the Committee on Ways and Means tentatively decided that for a 5-year period beginning December 31, 1973, private foundation charitable expenditure rules in Section 4942 would be modified so that a foundation would not be required to reduce the value of its endowment below the value on December 31, 1970; however, this rule would not reduce the charitable expenditure requirement below the greater of (1) 4 percent of the value of the endowment or (2) the foundation's income for the year. Such an amendment (hereinafter referred to as the "freeze base amendment"), has merit in that it recognizes that there are inequities with the application of Section 4942, but provides no substantive relief to this Group by virtue of the valuation date or freeze base being December 31, 1970:

MARKET VALUES

Foundation	May 26, 1969	Dec. 31, 1970	Dec. 31, 1971	Dec. 31, 1972	Dec. 31, 1973	Oct. 31, 1974
Hormel.....	\$9,977,672.08	\$9,912,111.08	\$11,156,415.54	\$10,136,157.03	\$8,885,073.76	\$8,162,010.59
Kellogg.....	354,000,000.00	434,117,760.00	488,382,480.00	567,400,442.00	560,735,440.00	524,558,960.00
Kresge.....	437,380,000.00	453,596,000.00	717,340,000.00	872,033,000.00	644,395,000.00	511,602,000.00
Maclellan.....	45,800,187.00	43,997,030.00	59,684,496.00	87,994,061.00	81,683,012.00	52,291,553.00
Pew Memorial Trust.....	425,832,471.00	335,845,239.00	405,985,261.00	579,818,369.00	579,818,369.00	519,298,523.00
Woodruff.....						

It is believed that the following example illustrates the application of the freeze base amendment to Section 4942:

Assume that Private Foundation A (hereinafter A) and Private Foundation B (hereinafter B) each have an endowment value of \$100 million on December 31, 1970; on December 31, 1975, A's value is \$100 million and B's value is \$150 million. Further assume that A's income for 1975 is \$4.5 million and B's income is \$6.75 million. Without regard to the freeze base amendment and assuming the applicable percentage in Section 4942(e) (3) is 7 percent, A's minimum income distribution would be \$7 million resulting in a corpus reduction of \$2.5 million (\$7 million required distribution minus \$4.5 million income) and B's would be \$10.5 million resulting in a corpus reduction of \$3.75 million (\$10.5 million required distribution minus \$6.75 million income).

Applying the amendment, both A and B have a so-called "freeze base" of \$100 million. Since the application of Section 4942(e) (3) would cause A to fall below its freeze base, it would be required to pay out the greater of its income (\$4.5 million) or 4 percent of the freeze base (\$4 million). Thus, the amendment would protect A's endowment, not including any shrinkage due to inflation. In B's case, the application of Section 4942(e) (3) would not cause it to fall below its freeze base and accordingly it would have to pay out the full \$10.5 million which would result in an endowment loss of \$3.75 million plus inflation.

In brief the freeze base amendment is welcomed because it indicates that the Treasury and the Committee on Ways and Means recognizes that Section 4942 must be amended. However, if this type of amendment is enacted, it must be modified, otherwise the same problems that exist with the statute as enacted in 1969 will continue to exist.

### 3. Action Which Should and Must Be Taken

*a. Legislative.*—Because of the effective date provision in the Tax Reform Act of 1969, Congress must amend Section 4942 this year; if not, private foundations may be faced with a minimum investment percentage of 8 percent or more by 1975. This would be at a time when the corpus of most private foundations is actually shrinking, reflecting both the stock market drop and the double digit inflation. This would further reduce private foundations' ability to keep pace with inflation and to provide charitable contributions for future generations equal to those now being distributed. In order to prevent this irreparable harm to the nation's charitable institutions' grant making policy, the Committee on Senate Finance should favorably consider taking immediate action on amending Section 4942 (this year).

Since both the staffs of the Treasury and the Joint Committee have worked on the development of the freeze base concept subsequent to H.R. 11197, it is logical to assume that this concept is appropriate for immediate consideration by the Committee on Finance in its efforts to correct the inequities of Section 4942. However, it is obvious that the freeze base concept tentatively adopted by the Committee on Ways and Means must be further developed to insure that this concept does not penalize those foundations whose investment policies have created a more valuable endowment over the years. The previous example amply illustrates this point, *i.e.*, Private Foundation A, whose endowment remained stable was properly benefited, whereas Private Foundation B, whose endowment value had risen was not. In fact, B would be forced to divest assets (notwithstanding Section 4943) even though it may be assumed that its endowment and charitable distributions steadily increased over the years.

A refinement of the freeze base concept would be to have a moving annualized base, *i.e.*, instead of a constant endowment value as of December 31, 1970, the base for each year should be the endowment value as of December 31 of the previous year. This concept may be illustrated with the prior example except that A's December 31, 1974 endowment value is \$100 million and B's December 31, 1974 value is \$148 million. For A, the result would be the same as in the previous example. However, for B the minimum distribution would be its income of \$6.75 million (which is greater than 4 percent of \$148 million). This results from the fact that the application of Section 4942(e) (3) would cause an endowment reduction below the December 31, 1974 valuation (or annualized base) of \$148 million (7% of \$150 million=\$10.50 million—\$6.75 million income=\$3.75 million from endowment; \$150 million endowment—\$3.75 million=\$146.5 million).

With any of the foregoing refinements, the concept applies fairly to all private foundations. Obviously, such an amendment would be a step toward the elimina-

tion of the slow unintended death of private foundations due to the statutory deficiencies previously set forth.

*b. Administrative.*—Under Section 4942(e) (3) the Secretary of the Treasury is authorized to establish the applicable percentage in determining the minimum investment return. The Treasury last exercised this power on April 24, 1974, in T.I.R. No. 1288. While no public information has been made available as to what information the Treasury utilized in determining the appropriate rate, it is our understanding that it was based upon U.S. Treasury intermediate obligations. The statute mandates that the Secretary consider "money rates and investment yields". Based upon the legislative history, it must be assumed that investment yields is the equivalent of dividend yields. In this connection, The Report's conclusion that "The adoption of a reasonable standard in the case of Section 4942 would seem both appropriate and wise," is wholeheartedly endorsed. Moreover, in light of the fact that time may not permit legislative relief this year, it would be appropriate for the Committee on Senate Finance to direct the Secretary to include investment yields as well as interest rates in its calculations for Section 4942(e) (3).

The Report also "... recommended that Section 4942 be amended to give the public opportunity to comment on proposed changes in the applicable percentage." We obviously endorse this recommendation but also would like to point out to the Committee that the Secretary, without legislation, could propose the standards to be applied by Regulation and give the public an opportunity to comment by promulgating such rules in a Notice of Proposed Rule Making.

#### *D. Other Problems Related to Section 4942*

##### *2. Donative Intent*

In addition to the sound economics associated with owning securities, the trustees may be required to take actions contrary to the desires of the donors as expressed in original trust documents if they divested stock from corpus. Most of the large foundations today were born decades ago out of successful one-family directed corporations. In a national atmosphere that was receptive and generally grateful and in accordance with the law of the land then in effect, family leaders dedicated major portions of their personal fortunes to charity through the establishment of foundations and trusts in various forms. Their wisdom produced certain requirements and restrictions governing the conduct of their trustees. Provisions covered investment policies, income distribution guidelines and rules for grant making among other stated wishes and directions of the donors. As long as these provisions were legal when drawn, done in good faith, in the interest of charity, and provide for prompt payout of cash income, we believe they should prevail and not be subject to change after the program is underway. Surely such a policy will discourage future donors and strikes at the credibility of all tax incentives. The validity of this position was accepted in Section 4943 by virtue of transition rules concerning divestiture. Thus it is discouraging to be exempted from the divestiture requirements of Section 4943 only to be forced into divestiture by Section 4942.

Incidentally, the Group takes pride in pointing out to the Subcommittee that their performance has outdistanced those private foundations who diversified their portfolios rather than remaining in stock ownership in a few companies.

##### *2. Management Difficulties Caused by 1969 Rules*

There are problems that may not be obvious that a distribution rule based on current value introduces. First, the monthly valuation requirement consumes time and attention that is non-productive of charitable benefit. Foundation managers find themselves viewing investments like a speculator concerned with short-term market trends rather than with basic soundness of an investment. The short-term trend is not important to the long-term investor and his attention to underlying value is the area of legitimate interest. Instead, we see the current formula attaches such importance to current values that it cannot help but be diversionary.

Second—and probably more important—is the problem associated with handling grants. Foundations typically have some sort of application submission and screening process before final action and these preliminaries are time consuming for both the charity and foundation. It is difficult for the foundation

and the charities it supports not to have a fairly concrete and fairly long-term concept of the required distributor. It is unfair to a potential grantee to encourage an application when his likelihood of success is remote and it is unfair to the grants' committee not to have an adequate selection of applications. Thus, fluctuating levels of required distributions are inefficient for both the applicants and the trust.

*E. Diversification: Not the Answer, Case in Point*

From the foregoing discussion, it should be clear that the inequities of Section 4942 are not eliminated by virtue of a private foundation diversifying its portfolio. This statement was amply supported in our Testimony before the Committee on Ways and Means where the experience of the Kellogg Foundation was specifically set forth. In that case, the diversified portfolio out-produced mutual funds and yet it was out performed by the Kellogg stock. Despite an outstanding growth rate coupled with enormous charitable distributions, the Kellogg Foundation still cannot satisfy Section 4942. This example continues to be illustrative of the Group.<sup>4</sup>

*F. Ture Economic Study*

After three years there has been time to examine how Section 4942 will operate to undermine overall foundation grants, and there has been the opportunity to further examine the assumptions of the Peterson Report. For this purpose, the foundations subscribing to this statement have had an independent study prepared by Dr. Norman B. Ture. The findings and conclusion of that report, as briefly summarized in its own language, are as below:

"First, any minimum distribution rule which ignores the foundation's rate of return will have a highly differential, discriminatory and possibly capricious impact on foundations and on their long-term capacity to support charities.

"Second, the contention that the investment performance of foundations is relatively poor is based on inadequate information and inappropriate statistical measures; the records of foundations for which data was available in the preparation of this report certainly do not support this contention.

"Third, no sound evidence was advanced to support the view that the allegedly poor investment performance of foundations is related to the concentration of their investment assets.

"Fourth, it is neither realistic nor reasonable to assume that a minimum distribution rule will result in significant increases in the rate of return on foundation investment.

"Finally, the (this) report concludes that the tax savings allegedly realized by those establishing foundations are, in all likelihood, very small. Foundation distributions to charity have represented a sizeable amount of benefits relative to the foregone revenues."

In addition to the foregoing conclusions from the Ture Report, one other point must be made. Inflation increases the dependence of charitable institutions on private foundations and other private sources for a dependable and continuing flow of funds. The costs of programs normally supported by foundations, institutions, educational, health, and social service organizations have increased faster than the general rate of inflation. During the period 1958-1971 the average operating budgets for U.S. medical schools increased from \$2,056,000 to \$8,475,000 an increase of 412%. Since 1960 the average cost of a day in a U.S. hospital has gone up 204%—to \$92 in 1972. Physicians' fees, which cost Americans \$16.2 billion in 1972 were up 74% over 1960. Since the introduction of Medicaid and Medicare costs, for example, in Michigan, hospitals rose 105.4% between 1966 and 1971 with 19.6% of that rise being attributed to inflation. In institutions of higher education costs increased from 1953-54 to 1966-67 to an annual average of 3.5%, as compared with a rate of 1.6% for the consumers price index during the same period—a difference of 1.9%. These increasing costs are seen as limiting the work of many charitable organizations and come at a time when government programs can't meet demand and when budgetary considerations require cutbacks in federal spending. Thus, it is in the public interest that charitable organizations have future access to a number of sources of both private money and public spending to finance their activities. If Section 4942 is allowed to destroy private foundations, the Federal Government will be forced to replace the job now being done by the private sector.

<sup>4</sup> See Exhibit A.

## Conclusion

From the foregoing, three things are apparent: One, the underlying premise of the 6 percent minimum distribution rule is predicated upon false assumptions; two, the statutory formula forces endowment shrinkage which operates to the detriment of charity; and three, this rule must be changed if private foundations are to continue to be permitted to serve their function in the support of charitable undertakings.

The requirement of distributions to charity at a fixed or variable rate of 6 percent of the current market value of the foundation's assets, confronts foundation managers with difficult decisions that do not necessarily relate to the well being of charity. For example, many foundations hold all or substantial portions of the original gifts from their founders. This condition is often consistent with the founder's expressed desires as set forth in the declaration of trust, and, more importantly, the long-term performance of the donated holdings have justified continued retention rather than venturing into unknown territory through diversification of investments.

If Section 4942 is not amended, it is clear that the principles set forth in the Peterson Report and incorporated in Section 4942 will impair the effectiveness of all foundations and eliminate many of them to the detriment of charity. This position is not only supported by the Group's accomplishments and experience, but by the Ture study which indicates that private foundations can give better return per dollar to charity than the Federal Government. No one has suggested increasing the Government's role in advancing philanthropy, which is precisely what must happen if Section 4942 is not revised.

Our conclusion that Section 4942 must be revised is not inconsistent with our opening statement that private foundations have a moral and should have a legal obligation to make minimum annual charitable distributions; that is their function. The Group merely wishes to insure that they will exist in the future so that they will have such a function.

## Exhibit A

Because of the holding of Kellogg Common Stock by the W. K. Kellogg Foundation Trust, the Trust's market value since inception has appreciated over tenfold and in a manner quite unlike what the appreciation would have been if the assets were in a 50% diversified portfolio, a 33½% diversified portfolio, or in an all-bond account. The Trust's 1968 distributions to charity were from 275 to 318% more than would have been possible with income from a 50% diversified fund, from 337 to 481% more than they would have been from a 33½% diversified fund and 955% more than would have been possible from a fund comprised exclusively of bonds. The figures are as follows:

	Percent market appreciation 1968 over 1935	1968 Income	Percent 1968 Kellogg Income to other funds
W. K. Kellogg Foundation Trust.....	1047.5	\$12,661,770	.....
Diversified 50 percent common stock model.....	200.7	3,980,828	318
50 percent Standard & Poor's industrial and 50 percent Moody's AA bonds.....		4,599,428	275
Diversified 33½ percent common stock model.....	84.7	2,632,006	481
33½ percent Standard & Poor's Industrials and 66½ percent Moody's AA.....		3,753,593	337
All bond account.....	37.5	1,325,842	955

From the original gifts from the founder of \$45 million, which in 1973 had a fair market value of \$590 million, distributions to charity had then totaled \$272 million. 1973 income from the continued holdings of Kellogg Stock was 66.5%

greater than in 1967 compared with an increase at only 12.8% from our own diversified portfolio. The figures with 1974 now added are as follows:

Year ended August 31	W. K. Kellogg Foundation Trust		W. K. Kellogg Foundation diversified portfolio	
	Net income from Kellogg stock	Percent increase over 1967	Foundation income from other investments	Percent increase over 1967
1967.....	\$11,272,650		\$1,852,705	
1968.....	12,177,062	8.0	1,954,008	5.4
1969.....	14,438,092	28.0	1,834,420	(.9)
1970.....	14,890,298	32.0	1,831,344	(1.1)
1971.....	17,606,034	56.1	1,711,651	(7.6)
1972.....	17,349,265	53.9	1,941,018	4.7
1973.....	18,775,544	66.5	2,090,946	12.8
1974.....	19,413,750	72.2	2,229,290	20.3

Such a record could not have been achieved under the 6% minimum distribution rule of Section 4942 of the Tax Reform Act of 1969 since that rule would have mandated arbitrary and continuous invasions of corpus, an unsound practice in prudent fiscal management. Had the 6% distribution rule been in effect the following would have occurred:

1. From 1934 through 1972, the trust made an actual distribution of \$222 million. Had the minimum distribution rule been applicable, distributions of \$259 million (or an increase of \$37 million) would have been made;

2. To meet that payout requirement, the trust would have had to sell the equivalent of 18 million shares with a market value of \$265 million; therefore, the trust's holdings would have been reduced to a market value of \$265 million; and thus

3. The short-term higher return to charity of \$37 million would have cost \$265 million in corpus value, thereby reducing the current size of the trust by 50 percent. Further, for 1973-74 the distribution from the reduced assets would have been only \$10 million rather than \$20,193,682 which was in fact distributed.

In the current market debacle, in spite of havoc being played on portfolios of mutual funds, pension funds, and endowments of educational institutions, the return to charity from the investment in Kellogg continues to increase as reflected in the following table showing that gross income from Kellogg Stock in the fiscal year just completed was 103.6% greater than just 10 years ago—having risen steadily each year; and the market value of the holding of Kellogg Stock at 10/31/74 was 41.5% greater than at 12/31/69, and down only modestly (6.5%) from 12/31/73. By comparison, the decline in the Standard and Poor 500 Stock Index since 12/31/73 has been 24% and the Dow Jones Industrial Average is down 21%.

Fiscal year ended August 31	W. K. Kellogg Foundation Trust gross income from Kellogg stock	Market value of trust at December 31
1965.....	\$9,948,532	\$374,173,333
1966.....	10,852,944	330,110,380
1967.....	11,305,150	384,375,100
1968.....	12,209,562	375,330,980
1969.....	14,470,592	370,808,920
1970.....	14,922,798	434,117,760
1971.....	17,636,034	488,382,480
1972.....	18,088,240	567,500,442
1973.....	19,535,299	560,735,440
1974.....	20,258,829	524,558,960

Oct. 31, 1974.

During the period reflected in the above table, Kellogg Foundation grants increased an average of 7.25% per year through 1973. Also through 1973 there was an annual erosion due to inflation which averaged 3.94%. Thus it can be seen that through prudent fiscal management and the return of 100% of its income to charity, the Kellogg Foundation, through its grant-making process, has been able to more than counter the forces of inflation in its philanthropic endeavors. Specifically, its annual grants out-paced inflation through 1973 by an average of 3.31% per year. However, because of federal wage and price controls which limited dividends, Kellogg Foundation grants in 1974 were only 3.84% greater than 1973; thus keeping up with our first double-digit inflation in history during 1974 would have required massive invasions of corpus.

PREPARED STATEMENT PRESENTED TO THE WAYS AND MEANS COMMITTEE ALONG  
WITH A STUDY BY DR. NORMAN B. TURE ON TUESDAY, APRIL 10, 1973

I. INTRODUCTION

As a group we support the action taken by the Congress in the Tax Reform Act of 1969 to eliminate certain abuses previously associated with certain foundations. And, we strongly endorse the efforts of Congress to assure that Foundations operate properly in the public interest. We recognized then that the abuses of some Foundations necessitated corrective action, both to provide safeguards against the recurrence of those abuses and also to reassure the public that continued tax exemption for foundations would serve the national interest. On the other hand, we were concerned that correction of such abuses through undue and unnecessary restrictions might well be a disservice to that public interest if legitimate foundation operations were curtailed thereby.

Now, we are concerned because two of the rules adopted in 1969 unduly restrict legitimate foundation activities and, accordingly, urge that each of them be re-examined and changed. The first rule is the imposition of the 4% excise tax on net investment income of private foundations, and the second is the requirement that the annual distributions of private foundations must be at least equal to a certain percentage of the current value of their investment assets (hereinafter referred to as the "minimum distribution rule").

*A. Section 4940, 4 percent Excise Tax*

This Committee proposed a tax on the investment income of private foundations in 1969 for two reasons. First, it was thought that private foundations ought to help share the cost of government in light of their ability to pay. Second, it was felt that vigorous and extensive administration would be required to provide appropriate assurances that private foundations will promptly and properly use their funds for charitable purposes and that these foundations ought to bear the cost of this audit activity.

The Senate Finance Committee recommended the tax as an audit fee to reimburse the government for the cost of examining the finances and activities of private foundations.

Whether the ultimate rationale adopted by Congress was based on the ability of private foundations to pay part of the cost of government or the desirability of imposing an audit fee on private foundations, it is clear that the imposition of this tax singled out private foundations from all other tax exempt organizations, each of which presumably has an ability to pay, and each of which must ultimately be audited by the Internal Revenue Service. A more serious objection to the tax, however, is the fact that it directly reduces the funds available for distribution, thereby placing the ultimate burden for the tax on those charities which would otherwise receive the funds involved as grants.

We know of several instances in which the audit tax is almost twice as much as the total expenses of operating the Foundation, and others in which the audit fee is equal to the operating expenses of the Foundations.

Under the circumstances, we urge that the necessity for this tax be re-examined critically and eliminated or drastically reduced, since the rationale behind it is questionable and since the tax is borne by charitable beneficiaries who are least able to pay it and have heretofore been accorded an exemption from both direct and indirect taxation.

*B. Section 4942, the minimum distribution requirement*

Of more serious concern to this group is the requirement that private foundations pay out a fixed percentage of their investment assets each year in pursuit of their charitable activities. The rationale behind this novel concept was apparently



one, to insure that current distributions were sufficient to justify any tax benefit donors might receive from their contributions, and two, to prevent private foundations from growing indirectly by investing in the stock of companies which retained most of their earnings and thereby delaying indefinitely charitable expenditures commensurate with the value of their assets. In order to avoid this delay of benefit to charity, Section 4942 requires private foundations to make annual distributions at a prescribed level, even if an invasion of capital would be needed to do so.

Many commentators have found this approach objectionable, not only because it mandates an encroachment on capital, but also because many private foundations that are currently able to support major charitable programs are only able to do so because their assets have been historically invested to provide a reasonable appreciation in value as well as a fair current return.

Nevertheless, for purposes of this presentation the group has assumed that a foundation's total rate of return is the sum of dividends, interest, and capital gain realized and unrealized, divided by the market value of the assets.<sup>1</sup> More importantly, it should be unmistakably clear that none of the group is philosophically opposed to the concept of a minimum annual charitable distribution but rather is concerned with the method of determining such a distribution as set forth in Section 4942 and even if that method of determination were acceptable, the 6% rate should be reduced. In short, this group knows that Section 4942 as enacted in 1969 is detrimental to charity and the well being of this nation.

### *C. Foundations are important to America*

Part of the development of this nation has occurred at the instigation of private foundations. Any status which affects the existence of such foundations is bound to have an effect on the future of our country. This group is convinced that Section 4942 has the potential for the elimination of foundations, and accordingly, the potential for altering the country's future. This last conclusion is ironic since it is clear that the purpose for enactment was not to banish foundations from the country but to insure present and future grants to charity in relationship to tax benefits, if any, enjoyed by foundation donors. We attribute this delayed, but certain, death sentence and ultimate harm to the country to the unfounded conclusions of the Peterson Report which were presented to the Congress in 1960.

## II. THE SUBSTANTIVE PROVISIONS OF SECTION 4942

### *A. Legislative history*

#### *1. The concept of Section 4942, minimum distribution rule has its origin in the 1965 Treasury Report<sup>2</sup>*

The 1965 Treasury Report proposes a minimum investment return on the theory that there should be a correlation between the immediate tax benefit to the donor and the time of the benefit to charity.

The Report proposes two changes in the law to prevent the delay in benefit to charity. First, private foundations would be required to devote all of their net income to active charitable work on a reasonably current basis. Second, the Report provided for a minimum investment return, which it termed an "income equivalent formula."

It is apparent that the Report in attempting to place those foundations with low-yielding assets on a "parity with foundation having more diversified portfolios" did not intend to create a situation whereby *all* or most foundations would be required to dispose of their capital. Since it states that retention of capital is generally justifiable, the 6% payout in Section 4942(e) cannot be justified in light of this Report. Rather, it is apparent that it merely intended to upgrade the payouts of those foundations with minimal income<sup>3</sup> and to prevent a "significant lag" between the time of the tax benefit to the donor and time of benefit to the public. The Report proposed to solve this time lag by two provisions, one, a reasonably current distribution of all realized income (with the exception of long-term capital gain), and two, an income equivalent formula.

<sup>1</sup> This is the definition submitted to the Senate Finance Committee by Mr. Peter G. Peterson, Chairman of the Peterson Commission, testifying before the Senate Finance Committee on H.R. 13270 on October 22, 1969 (Cf. Report, P. 74.).

<sup>2</sup> Treasury Department Report on Private Foundations issued on February 2, 1965, submitted to the Committee on Ways and Means, H.R. Doc. No. 54-838, 89th Cong., 1st Sess. (1965).

<sup>3</sup> *Ibid.*, pp. 14, 36, 37.

The Report states that "the income equivalent should be comparable to the yield on investment funds held by comparable organizations—such as universities . . . . Based upon existing market conditions it would appear that a reasonable income equivalent would be in the range of three to three-and-one-half percent." Thus, it is obvious that the Report did not intend to require foundations to have such a high rate of return that it would be necessary to eat into its capital as Section 4042 clearly requires. Supporting data for the Report established that approximately 90% of foundations had ordinary income of less than six percent of their fair market value. Copies of the relevant tables published in the 1965 Treasury Report are attached as Appendix A.

The first hint that the minimum return proposal as adopted in 1969 might be above three or three-and-one-half percent, appears at page 301 of Secretary Fowler's statement to Congress on December 11, 1968. In illustrating the operation of the minimum payout requirement, Fowler states: "For example, assuming a five percent income equivalent. . . ." (Emphasis added.)

## 2. Ways and Means Committee Report (Page 25)<sup>4</sup>

The Report on the Committee on Ways and Means gives the following as its "general reasons for change" in existing law: "Under present law, if a private foundation invests in assets that produce no current income, then it need make no distributions for charitable purposes. As a result, while the donor may receive substantial tax benefits from his contribution currently, charity may receive absolutely no current benefit. . . . A graduation of sanctions designed to produce current benefits to charity is provided."

## 3. Treasury Statement to Senate Finance Committee

In the Treasury statement to the Senate Finance Committee, Edwin S. Cohen expressed support for the bill as passed by the House including the five percent minimum investment return.<sup>5</sup> The Senate Finance Committee passed the provision substantially as it passed the House.

## 4. Percy Amendment

The bill was amended on the Senate floor by Senator Percy. His amendment raised the minimum investment return from five percent to six percent. Senator Percy stated that this increase was based on the Peterson Commission. The Peterson Commission recommended a minimum investment return of six to eight percent. It recognized, however, that this included unrealized appreciation. The floor debate is contained in the Congressional Record of December 6, 1969, at Pages S15959 through S15964 and explains Senator Percy's action:

(1) The higher percentage would make foundations more vigorous in their investment policies;

(2) Private foundations should make "substantial annual distributions" to charity to help meet rapidly accelerating charitable needs; and

(3) Data on university endowments and professionally managed funds show that six percent is fair and reasonable, especially considering that many mutual funds have averaged an "appreciation" of ten percent. (Emphasis added.)

Senator Percy further stated that, more important than the particular percentages, are the assumptions on which the percentage should be based: "The payout requirement should be high enough to require them (private foundations) to invest their funds productively. *The percentage should not be so high as to amount to a delayed death sentence.*" (Emphasis added.)

Percy also cited the following additional reasons as grounds for a higher percentage:

(1) The peculiar nature of foundations as grant-making institutions;

(2) The correlation between tax deduction and a prompt charitable benefit; and,

(3) Perpetual existence should be a reward only for continuing productivity, not an automatic privilege.

<sup>4</sup> H.R. Rep. No. 413, 91st Cong., 1st Sess., 25 (1969).

<sup>5</sup> Thus, it is clear Mr. Cohen recognized that a five percent minimum return would require the distribution of corpus. This is contrary to the 1965 Treasury recommendations. Moreover, the concept of corpus depletion is inconsistent with "curing" the potential abuses cited in the 1965 report but is with ending foundations as charitable vehicles by forcing dissipation of corpus.

### 5. Conclusion

The rationale originally expressed in the 1965 Treasury Report was that there should be a correlation between the timing of the tax deduction and the benefit to charity. The 1965 study proposed to insure that its objective would be accomplished by requiring an income equivalent equal to that earned by similar organizations—i.e., colleges and universities. The study stated that this percentage would be three or three-and-one-half percent. This study was the backbone for H.R. 13270. As the bill passed along its various stages, Congress was further influenced by the Peterson Commission. The six percent payout requirement finally enacted represents a one hundred percent increase in the minimum payout requirement initially proposed by the Treasury Department in 1965. In addition, it is premised upon and reflects the inaccurate conclusions of the Peterson Commission.

#### *B. Minimum distribution rule is wrong*

Chapter 42 of the Tax Reform Act of 1969 promulgated a new concept in regard to private foundations. Instead of regarding those who had transferred their funds to a charitable trust as persons to be held in public esteem, the attitude seemed to be that these persons were probably up to nefarious tax schemes warranting elaborate safeguards. The implication somehow was that the Treasury was being cheated.

#### *1. Difficulties in Rule Based on Current Value*

The requirement of distributions to charity at a rate of 6 percent of the current market value of the foundation's assets, confronts foundation managers with difficult decisions that do not necessarily relate to the well being of charity. For example, many foundations hold all or substantial portions of the original gifts from their founders. This condition is often consistent with the founders' expressed desires as set forth in the declaration of trust, and, more importantly, the performance of the donated holdings have justified continued retention rather than venturing into unknown territory through diversification of investments.

The 6 percent is not realistic. Value Line Investment Survey indicates that 1,400 divided paying stocks will pay an average of 3.6 percent in dividends in the next twelve months when measured against recent (early March) market prices. Using this as a measuring stick, it can be seen that most foundations would thus be forced to reduce principal assets. Obviously, this serves charity today but also obviously reduces charitable distribution for the next year and subsequent years. Perfect examples of this conclusion are the Emily and Ernest Woodruff Foundation and the Joseph B. Whitehead Foundation.<sup>6</sup>

In the case of the Emily and Ernest Woodruff Foundation, its qualifying distributions during the years 1939-1972 were in excess of \$113,959,396. If a 6 percent annual payout requirement had been in effect since 1939 and the Foundation had distributed just enough each year to meet the requirement, its aggregate distributions would have been \$92,237,015, or \$21,722,381 less than the amount actually paid out for this period. However, because mandatory invasions of capital would have been required to meet the 6 percent standard during some of these years, it is estimated that the present value of the Foundation's assets, \$260,837,180, would have been reduced to \$188,132,423, a decline of almost 30 percent and that the income of the Foundation, \$3,206,788, would have been reduced to \$2,077,691, a decline of more than 33½ percent.

The same figures for the Joseph B. Whitehead Foundation are even more arresting. In that instance, total qualifying distributions for the years 1940-1972 were \$15,061,837, whereas the 6 percent annual requirement would have necessitated distributions of \$16,045,078. Admittedly, almost \$1,000,000 would have been paid out for charitable purposes over this 32 year period if the mandatory distribution rule had been in effect, but the cost to the Foundation would have been staggering. For example, on December 31, 1972, the market value of its assets was \$92,662,157 whereas those assets would have been reduced to \$81,606,448 and its current income of \$1,308,033 would have been reduced to \$349,064 by the 6 percent payout rule. In other words, the asset shrinkage to provide that \$1,000,000 additional payout would be slightly more than \$81,000,000 and the loss of almost \$1,000,000 of current income indicates that the differential, if indeed there was one, would be made up in approximately one year.

<sup>6</sup> The same is reflective for the group.

The figures which we have compiled in this regard, and similar information gathered by the other Foundations represented illustrate without a doubt that the minimum distribution rule will, based on these actual figures, cost the charitable beneficiaries of these foundations a staggering amount, if past history repeats itself.

These results occur because the minimum investment return rule is expressed as a fixed percentage of the fair market value of the assets held by a private foundation. Often this fair market value is established by a public market, as in the case of common stocks of companies listed on a national stock exchange. In these instances, the traditional indicia of value is the public's expectancy of future earnings. Therefore, increased current earnings by the companies involved produce a proportionately greater increase in traded value, necessitating a greater invasion of principal to comply with the payout requirement. An example would be Foundations holding the common stock of a single company which is traded on the New York Stock Exchange. Because this company has enjoyed good management and a highly favorable earnings pattern over the years, it frequently trades at a multiple of more than 40 times earnings on the market. In 1972, this company reported earnings of \$3.19 a share on its outstanding stock, and when those earnings were announced on April 5, 1973, its stock closed at a value of \$137.50 a share. If this per share value is multiplied by 6 percent, the rate is \$8.25 a share. When this figure is compared to the earnings per share of \$3.19, it becomes apparent that the payout requirement is more than 260 percent of the current earnings of the company, indicating that the Foundations can never expect dividends to equal a payout requirement which is tied to the investing public's high regard for the value of the stock in question.

Obviously, not all stocks sell at such a high price earning ratio. In fact, in today's economy with stocks selling at 15 to 16 times annual earnings rate, no one can expect dividend rates to exceed the 3.6 percent average set forth in the Value Line Investment Survey. This is true because most companies, if they are to grow and remain financially sound, must limit their dividend distributions to a maximum of 50-60 percent of earnings. Many companies, such as the extractive industries, are forced to retain larger portions of earnings to underwrite exploration and development programs. Likewise, other groups, faced with constant heavy drains for research and development costs, must limit their dividend payments to small percentages of annual earnings in order to provide funds for expanding operations. Thus, many sound companies simply cannot pay out enough dividends to support a 6 percent payout.

This point may be again illustrated by the following example: Assume a stock earns \$5 per share. It would sell at about \$75 with a multiple of 15. If it paid 60 percent of its earnings as dividends, the dividend would be \$3 and the yield 4 percent—a little higher than normal. The retained earnings of \$2 would probably not cover depreciation from inflation.

Hopefully, it should be clear that there is no general rule to correlate stock prices and earnings. Some sell at 5 or 6 times earnings and could yield 6 percent or better; others at 40 or 50 times earnings so they have no possibility of such a yield currently. Thus, it is irrational to have a general rule requiring payments based on current values that in no way reflect current earnings.

The irony of this situation is clear. Private foundations are now forced to sell sound income-producing common stocks held over a long period of time only because the investing public places a high value on those same shares for future appreciation potential. In fact, the greater the potential for a common stock, the more difficult it is for a private foundation to hold or secure that common stock for its own portfolio. This foreclosure of private foundations from investments in marketable securities which are recognized by investors for their proven performance would appear to be based on an invalid assumption concerning the long range responsibility of these foundations.

Prices which investors will pay for shares in our companies usually reflect an evaluation of the *future* earning capacity of the company, both short and long range. The nature of the operation and the romance in its future will determine the general range of market prices, but always subject to varying degrees of influence from the outside factor at work in the market place; war or peace, inflation, cost of living, foreign trade balances, foreign exchange rates, cost of money and so on and on. This explains why many foundation managers choose to stay invested in the companies they know best.

No matter how the problem is stated, under the 1969 Tax Reform Act, foundations must tap their capital resources for the difference between the required

distribution rate of 6 percent and their actual cash income. This is unfortunate for foundations and bad for charity.

In addition, the trustees may be required to take actions contrary to the desires of the donors as expressed in original trust documents. Most of the large foundations today were born decades ago out of successful one-family directed corporations. In a national atmosphere that was receptive and generally grateful and in accordance with the law of the land then in effect, family leaders dedicated major portions of their personal fortunes to charity through the establishment of foundations and trusts in various forms. Their wisdom produced certain requirements and restrictions governing the conduct of their trustees. Provisions covered investment policies, income distribution guidelines and rules for grant making among other stated wishes and directions of the donors. As long as these provisions were legal when drawn, done in good faith, in the interest of charity, and provide for prompt payout of cash income, we believe they should prevail and not be subject to change after the game is underway. Surely such a policy will discourage future donors and strikes at the credibility of all tax incentives.

## *2. Management Difficulties Caused by 1969 Rules*

There are problems that may not be obvious that a distribution rule based on current value introduces. First, the monthly valuation requirement consumes time and attention that is non-productive of charitable benefit. Foundation managers find themselves viewing investments like a speculator concerned with short-term market trends rather than with basic soundness of an investment. The short-term trend is not important to the long-term investor and his attention to underlying value is the area of legitimate interest. Instead, we see the current formula attaches such importance to current values that it cannot help but be diversionary.

Second—and probably more important—is the problem associated with handling grants. Foundations typically have some sort of application submission and screening process before final action and these preliminaries are time consuming for both the charity and foundation. It is difficult for the foundation and the charities it supports not to have a fairly concrete and fairly long-term concept of the required distributions. It is unfair to a potential grantee to encourage an application when his likelihood of success is remote and it is unfair to the grants committee not to have an adequate selection of applications. Thus, fluctuating levels of required distributions are inefficient for both the applicants and the trust.

An example will illustrate the problem. Let us assume that a foundation has dividend income of \$1,000,000 and investment management expenses of \$30,000 so it has \$970,000 to use for charity out of income. If the corpus is \$25,000,000, the minimum distribution at 6 percent would be \$1,500,000 so corpus must be invaded in the amount of \$530,000.

The next year the stock market takes a different view of the stock and it is valued at \$35,000,000 while dividend income remains constant. This means that minimum distributions rise to \$2,100,000 and the corpus invasion more than doubles to \$1,130,000.

A staff established to process applications for \$1,500,000 will be inadequate for \$2,100,000; likewise, the expectations of charity built on a year when \$2,100,000 is distributed will not be met when a lower year follows. One of the frequent challenges to the foundation is to engage in new and innovative activities. This means fuller exploration of the non-traditional applications and probably a longer time between application and grant. At any rate, the fluctuating minimums—particularly at an unrealistic level—will obviously be counterproductive to any desire to get into fields requiring greater attention per application. This serves to prevent foundation managers from being efficient and frustrates the objectives of foundation grants.

## *C. Statement of Impact*

### *1. Diversification: Not the Answer, Case in Point*

As stated above, the object of the minimum distribution rule reflected in Section 4942 was to assure that the amount of distributions by foundations to charities was sufficiently high to justify the tax savings afforded to those establishing such foundations. Therefore, it is fair to examine the group of foundations subscribing to this statement for the purpose of determining whether or not the

tax savings afforded to their founders have in fact been earned by adequate payment to charities. In this connection, we will use the experience of the Kellogg Foundation as illustrative for its experience is representative of and consistent with that of the group of foundations subscribing to this statement.

The founder of the Kellogg Foundation and virtually the sole contributor to it, W. K. Kellogg, realized total tax benefits (income, gift and estate) well below \$500,000 on gifts which today have a total fair market value of approximately \$590 million. The total of these assets are maintained on behalf of the Foundation in what may be said to be two separate portfolios (hereinafter "Kellogg" and "Diversified"). Kellogg consists entirely of Kellogg Company stock which represents less than 51 percent of the total stock of the Kellogg Company, having an approximate value today of \$543 million.

Diversified consists of stocks, bonds and other interest-bearing obligations which is expertly managed and has an approximate value of \$48 million. Kellogg has consistently out performed Diversified which was established to measure the fruits of diversification and to establish a standard of investment performance in order to evaluate the continued holding of Kellogg stock.<sup>7</sup>

A principal contention reflected in the Peterson Report, which has been referred to above, was that the portfolios of private foundations had not produced the rate of return which it was thought to have been produced by mutual funds.

By any measure of return, this group has out-produced mutual funds for the period covered by the Peterson Report and has continued to do so since. The point is that this portfolio has not only out-performed the standard set by the 1965 Treasury Report (3 to 3.5 percent annual return for tax exempt entities) but has exceeded that of the mutual fund standard. For example, in the last six years the Kellogg Foundation's income has continued to be substantially greater than it would have been had its income been derived entirely from diversified investments. The increase was 53.9 percent for income received from the Kellogg holdings as compared to an increase of 4.7 percent on the Foundation's diversified portfolio. Obviously, this result shows that the diversification of funds would result in a great handicap to meeting the payout requirements of the Tax Reform Act of 1969 and result in a lower return to charity over the years.

### *2. Assume Section 4942 Was Enacted From Creation*

Again we will use the Kellogg Foundation as being illustrative of the group.

(1) Assume that the minimum distribution rule had been in effect at 6 percent from 1934.

(2) In that year, Kellogg contained 221,000 shares of Company, fair market value \$87,570,000.

(3) From September 1, 1934, through August 31, 1972, the Foundation made an actual distribution of \$203,092,196.

(4) If the minimum distribution rule had been applicable, distributions of \$242,706,811 (or an increase of \$39,614,615) would have been made.

(5) However, the Foundation would have had to sell the equivalent of 8,818,928 shares with a market value of \$214,839,495.

(6) Thus, the Foundation's holding would have been reduced to 9,274,812 shares with a market value of \$226,061,355.

(7) The higher return to charity of \$39,614,615 would have cost \$214,839,495 thereby reducing the current size of the Foundation by almost 50 percent.

(8) In 1973 the distribution under the reduced assets would be \$10,016,257 rather than \$19,535,899 which it will distribute, almost 100 percent greater than the amount called for by blind application of the minimum distribution rule.

In summary, the facts establish the proposition that charity would have benefited in the short run by the minimum distribution rule, but only at great cost to the assets of the Foundation. Further, due to the depletion of these assets, the current and ergo the future benefit to charity would have to be reduced dramatically.

### *3. True Economic Study*

After three years there has been time to examine how Section 4942 will operate to undermine overall foundation grants and there has been the opportunity to further examine the assumptions of the Peterson Report. For this purpose,

<sup>7</sup> It must be borne in mind that the trustees have the discretion to sell the Kellogg stock.

the foundations subscribing to this statement have had an independent study prepared by Dr. Norman B. Ture. Filed herewith and incorporated in this statement is that study, entitled "The Impact of the Minimum Distribution Rule on Foundations", prepared by Norman B. Ture, Inc., at the direction of the Ad Hoc Committee on Section 4942. The findings and conclusion of that report, as briefly summarized in its own language, are as below:

"First, any minimum distribution rule which ignores the foundation's rate of return will have a highly differential, discriminatory and possibly capricious impact on foundations and on their long-term capacity to support charities.

"Second, the contention that the investment performance of foundations is relatively poor is based on inadequate information and inappropriate statistical measures; the records of foundations for which data was available in the preparation of this report certainly do not support this contention.

"Third, no sound evidence was advanced to support the view that the allegedly poor investment performance of foundations is related to the concentration of their investment assets.

"Fourth, it is neither realistic nor reasonable to assume that a minimum distribution rule will result in significant increases in the rate of return on foundation investments.

"Finally, the (this) report concludes that the tax savings allegedly realized by those establishing foundations are, in all likelihood, very small. Foundation distributions to charity have represented a sizeable amount of benefits relative to the foregone revenues."

#### 4. Peterson Report Ignores Increased Needs of Charity

The Peterson Report assumed that the charitable services which a foundation normally supports will not rise in cost any faster than the general rate of inflation and for that purpose assumed a rate of inflation of 2 percent. *The Report's assumption is wrong*, for it completely disregards the fact that the organizations supported by foundations have little possibility of similar gains in productivity.

The costs of programs normally supported by foundations have increased faster than the general rate of inflation. These increasing costs are seen as limiting the work of many charitable organizations and come at a time when government programs can't meet demand and when budgetary considerations require cutbacks in Federal spending. This situation increases the dependence of charitable institutions on private foundations and other private sources for a dependable and continuing flow of funds. It is in the public interest that charitable organizations have access to a number of sources of both private money and public spending to finance their activities.

Over the years, this group has supported charitable institutions engaged in higher education, medical and health education, and hospital services. Attached hereto is Appendix B illustrating the increasing costs experienced by these organizations.

#### 5. Conclusion

From the foregoing, two things are apparent: One, the underlying premise of the 6 percent minimum distribution rule is predicated upon false assumptions; and two, this rule must be changed if private foundations are to continue to be permitted to serve their function in the support of charitable undertakings.

If this is not done, it is clear that the principles set forth in the Peterson Report and incorporated in Section 4942 will impair the effectiveness of all foundations and eliminate many of them to the detriment of charity. This position is not only supported by the groups' accomplishments and experience, but by the Ture study which indicates that private foundations can give a better return per dollar to charity than the Federal Government.

No one has suggested increasing the Government's role in advancing philanthropy, which is precisely what must happen if the 6 percent rule of Section 4942 is not revised downward.

#### APPENDIX A

Tables published in the 1965 Treasury Report which indicate that approximately 90 percent of foundations have ordinary income of less than 6 percent of their fair market value.

TABLE 12.—DISTRIBUTION OF NUMBER OF FOUNDATIONS BY VARIOUS RATIOS

	Percent of donor-related influence over investment policy						Asset size			
	All founda- tions	50 percent or more	Over 33 percent, not over 50 percent	Over 20 percent, not over 33 percent	Not over 20 percent	Unclassi- fied	Very large, over \$10,000,000	Large, \$1,000,000 to \$10,000,000	Medium, \$100,000 to \$1,000,000	Small, under \$100,000
Total.....	14,850	10,990	810	100	2,420	530	164	800	4,910	2,980
Ratio of grants to contributions received:										
Below 25 percent.....	2,010	1,530	60	10	360	50	6	60	620	1,320
25 percent to 50 percent.....	1,770	1,370	130	1	240	40	7	60	680	1,020
50 percent to 100 percent.....	2,620	2,220	80	20	230	70	7	70	850	1,700
100 percent to 150 percent.....	1,550	1,240	100	4	150	50	8	80	840	1,020
Over 150 percent.....	2,060	1,460	100	20	390	80	58	250	730	1,020
No computation (no contributions received).....	4,850	3,180	330	40	1,060	230	78	280	1,590	2,900
Ratio of total income to book net worth:										
Total income negative.....	990	800	70	10	50	50	1	20	370	600
0 to 1 percent.....	3,600	2,940	160	10	360	140	7	30	400	3,160
1 to 3 percent.....	2,830	2,095	150	10	470	110	11	100	1,060	1,660
3 to 6 percent.....	4,730	3,350	260	50	950	110	63	360	2,040	2,260
6 to 10 percent.....	1,260	890	90	20	260	10	55	180	520	500
Over 10 percent.....	1,150	730	60	10	270	90	26	100	460	560
No computation (no book net worth).....	310	190	20	0	80	20	1	10	60	240
Ratio of total income to market net worth:										
Total income negative.....	900	800	70	10	50	50	1	20	370	600
0 to 1 percent.....	3,640	2,920	190	10	370	140	7	40	390	3,200
1 to 3 percent.....	3,270	2,440	160	20	530	110	28	140	1,280	1,820
3 to 6 percent.....	4,620	3,240	270	50	950	120	89	420	1,990	2,120
6 to 10 percent.....	930	690	50	3	180	3	27	100	390	420
Over 10 percent.....	1,150	720	50	4	300	80	11	70	450	620
No computation (no market net worth).....	260	170	20	0	50	20	1	20	40	200



Ratio of ordinary income to book net worth:										
Ordinary income negative.....	440	260	50	10	60	30	0	10	200	180
0 to 1 percent.....	3,810	3,160	170	10	370	130	9	20	430	3,880
1 to 3 percent.....	3,600	2,720	100	50	550	160	15	140	1,360	2,150
3 to 6 percent.....	5,280	3,720	310	15	1,070	140	87	460	2,330	2,440
6 to 10 percent.....	840	550	80	5	170	30	40	110	310	380
Over 10 percent.....	570	400	20	10	120	20	12	50	280	280
No computation (no book net worth).....	310	190	20	0	80	20	1	10	60	110
Ratio of ordinary income to market net worth:										
Ordinary income negative.....	440	260	50	10	60	30	0	10	220	180
0 to 1 percent.....	3,880	3,150	200	20	390	130	10	30	120	120
1 to 3 percent.....	4,140	3,120	190	50	640	160	44	220	1,040	2,000
3 to 6 percent.....	4,990	3,500	280	2	1,020	140	90	460	2,200	2,180
6 to 10 percent.....	570	390	50	4	100	30	16	40	240	240
Over 10 percent.....	620	420	10	10	160	20	3	30	220	220
No computation (no market net worth).....	260	170	20	0	50	20	1	20	40	240
Ratio of grants to book net worth:										
0 to 1 percent.....	1,370	730	120	20	450	50	9	20	280	1,000
1 to 3 percent.....	1,470	1,000	110	20	280	60	14	90	680	740
3 to 6 percent.....	2,810	1,890	190	10	670	60	66	280	1,120	1,000
6 to 10 percent.....	1,820	1,410	80	10	250	70	44	170	860	740
Over 10 percent.....	7,070	5,780	300	40	680	270	30	220	1,600	5,160
No computation (no book net worth).....	310	190	20	0	80	20	1	12	60	240
Ratio of grants to market net worth:										
0 to 1 percent.....	1,440	730	120	20	510	50	9	30	280	1,120
1 to 3 percent.....	1,820	1,200	160	20	380	60	39	160	810	280
3 to 6 percent.....	2,750	1,850	190	10	630	60	76	280	1,350	1,040
6 to 10 percent.....	1,710	1,380	40	2	220	60	28	140	810	740
Over 10 percent.....	6,880	5,660	270	46	670	280	11	190	1,620	5,000
No computation (no market net worth).....	260	170	20	0	50	20	1	20	40	200

<sup>1</sup> Differs slightly from number in Tables 10 and 11 because this table excludes about 10 large foundations for which data were not available when this table was prepared.

Source: 1964 Treasury Department Survey of Private Foundations.

TABLE 14.—PERCENT OF FOUNDATIONS IN VARIOUS CATEGORIES WHOSE TOTAL GRANTS WERE LESS THAN CERTAIN PERCENTAGES OF NET WORTH

	Foundations whose grants were less than—							
	1 per- cent—	3 per- cent—	6 per- cent—	10 per- cent—	1 per- cent—	3 per- cent—	6 per- cent—	10 per- cent—
	Of market net worth				Of book net worth			
All foundations.....	10	22	40	52	9	19	38	50
Foundations with donor-related influence—								
Over 50 percent.....	7	18	34	47	7	16	33	46
33 to 50 percent.....	15	35	59	64	15	28	51	61
20 to 33 percent.....	21	43	57	59	21	41	52	58
0 to 20 percent.....	21	37	63	72	19	30	38	68
Very large.....	5	29	76	93	5	14	54	81
Large.....	4	24	57	76	2	14	49	70
Medium.....	6	22	50	66	6	19	48	65
Small.....	12	21	33	41	12	20	32	40
All foundations except small:								
Total.....	5	22	51	68	5	18	48	66
Foundations with donor-related influence—								
Over 50 percent.....	4	20	48	67	4	16	45	64
20 to 50 percent.....	10	39	68	74	10	26	57	72
0 to 20 percent.....	8	25	60	72	8	19	56	71

<sup>1</sup> The remaining 48 percent of foundations contributed 10 percent or more of their market net worth, 60 percent contributed 6 percent or more, 78 percent contributed 3 percent or more, *et cetera*.

Source: 1964 Treasury Department Survey of Private Foundations.

TABLE 15.—PERCENT OF FOUNDATIONS IN VARIOUS CATEGORIES WHOSE ORDINARY INCOMES WERE LESS THAN CERTAIN PERCENTAGES OF MARKET NET WORTH

	Foundations whose ordinary incomes were less than—				
	0 percent	1 percent	3 percent	6 percent	10 percent
	of market net worth				
All foundations.....	3	29	57	90	94
Foundations with donor-related influence—					
Over 50 percent.....	2	31	59	91	94
33 percent to 50 percent.....	7	31	58	90	96
20 percent to 33 percent.....					
Under 20 percent.....	3	19	45	87	93
Very large foundations.....	0	6	31	89	98
Large foundations.....	1	5	32	89	93
Medium foundations.....	4	13	44	91	95
Small foundations.....	2	40	66	90	93

Source: 1964 Treasury Department Survey of Private Foundations.

A certain number of foundations are so-called conduit foundations which are organized simply to receive contributions and more or less immediately distribute these to charitable recipients. These foundations are likely to have very little in the way of net worth, and almost necessarily their ratio of total grants to net worth would be very high. One device for separating out many of the conduit foundations is to eliminate from consideration all foundations with total assets of less than \$100,000. The resulting calculations are shown on the bottom four lines of table 14. Looking at the line for the total of all foundations with assets of over \$100,000, it will be seen that the percentage of foundations that distributed in grants less than 1 percent.

Table 17 shows some percentage calculations based on the calculation of ratios between grants to net worth and ordinary income to net worth for those foundations receiving no current contributions in 1962. As would be expected, a higher percentage of these foundations would be affected by a requirement that grants be a certain percentage of net worth than was true when this requirement was tested against all foundations. In this case about 40 percent of these foundations would be affected by a 3½ percent payout requirement while the percentage was about 25 percent for all foundations. It might be noted also that the earnings experience is somewhat better when one looks at foundations without contributions because, by and large, less of the assets tend to be in-

vested in highly liquid forms as might be appropriate where the foundation is serving only as a conduit. Most likely about 40 percent of these foundations have a current earnings rate in terms of ordinary income in excess of 3½ percent of market net worth. It would be expected that these foundations whose rate of return on net worth was relatively high should pretty much correspond to those foundations whose ratio of grants to net worth was also high. Nevertheless there would be some of the foundations whose rate of return was in excess of 3½ percent who would not have made a correspondingly high ratio of grants to net worth. The combined test of a volume of grants equal to the higher of 3½ percent of market net worth or ordinary income might affect about 50 percent of these foundations.

TABLE 17.—PERCENT OF FOUNDATIONS RECEIVING NO CURRENT CONTRIBUTIONS WHOSE TOTAL GRANTS AND ORDINARY INCOME WERE LESS THAN CERTAIN PERCENTAGES OF NET WORTH

	Foundations whose grants were less than—				Foundations whose ordinary income was less than—				
	1 per- cent—	3 per- cent—	6 per- cent—	10 per- cent—	0	1 per- cent—	3 per- cent—	6 per- cent—	10 per- cent—
	of market net worth				of market net worth				
All foundations receiving no current contributions.....	19	35	59	69	2	24	49	87	92
Foundations with no contributions received whose donor related influence was—									
Over 50 percent.....	17	29	49	61	2	29	53	88	92
33 percent to 50 percent.....	27	39	67	82	6	20	40	88	94
0 to 33 percent.....	24	49	84	98	1	11	41	84	92
Foundations with assets over \$100,000 with no contributions received whose donor related influence was—									
Over 50 percent.....	8	24	62	77	3	10	36	91	94
33 percent to 50 percent.....	5	38	74	79	0	5	42	99	100
0 to 33 percent.....	10	33	78	87	2	5	25	87	94

Source: 1964 Treasury Department Survey of Private Foundations.

#### APPENDIX B

Brief summary of the increased costs associated with higher education, medical education, and hospital services.

##### Higher Education

Higher education is a labor-intensive service sector of the economy in which it is difficult to achieve the gains in productivity that are experienced in goods-producing industries.

For purposes of historical comparisons of educational costs, the most useful data are those compiled by June O'Neill in a study conducted for the Carnegie Commission. Educational costs per credit hour consistently rose more rapidly than the consumer price index from 1953-54 to 1966-67. Over the period as a whole, educational costs rose at an annual average rate of 3.5%, as compared with a rate of 1.6% for the consumer price index—a difference of 1.9%. However, costs in private institutions of higher education rose more sharply than those in public institutions. The rate of increase for private institutions was 4.8%, or 3.2% more than the consumer price index, and for public institutions, 2.9%, or 1.3% more than the consumer price index.<sup>1</sup>

The most noticeable feature of the budgets of all institutions of higher education is how fast they have gone up in the years since World War II. Total educational and general expenditures on current account by all institutions of higher education went up from less than \$1 billion in 1945-46 to more than \$7 billion in 1963-64. Total educational and general expenditures less expenditures on organized research have gone up, on the average, more than 7% a year at all private universities and more than 12% a year in three institutions (Chicago, Princeton, and Vanderbilt). The direct instructional cost per student over the period 1955-66 works out to an average annual rate of increase of

<sup>1</sup> Source: "The More Effective Use of Resources—An Imperative for Higher Education," A Report and Recommendations by the Carnegie Commission on Higher Education, June 1972, pp. 33-38.

7.3% for Chicago, Princeton and Vanderbilt and to 8.3% for all private universities.<sup>2</sup>

### Medical Education

In the area of medical care, hospital costs and doctors' cost per patient show increases substantially above the general price cost index as illustrated in Bradford, Malt and Oates, "The Rising Cost of Local Public Services," *National Tax Journal*. In the period 1958-71, the average operating budget for medical schools increased from \$2,056,000 to \$8,475,000, an increase of 412%. The mean salary for basic science faculty and for all ranks of clinical science faculty increased 59% and 86% respectively in the following statistics:

#### AVERAGE OPERATING BUDGET FOR MEDICAL SCHOOLS (DOES NOT INCLUDE SPONSORED PROJECTS)

Year	Number of schools	Average budget
1958-59.....	85	\$2,056,000
1959-60.....	86	2,235,000
1960-61.....	87	2,461,000
1961-62.....	87	2,755,000
1962-63.....	87	2,944,000
1963-64.....	87	3,289,000
1964-65.....	87	3,674,000
1965-66.....	87	4,230,000
1966-67.....	87	4,933,000
1967-68.....	89	5,518,000
1968-69.....	91	6,324,000
1969-70.....	93	7,206,000
1970-71.....	92	8,475,000

Note: The number of schools reporting equaled total number of schools existing in all years except 1970-71 when 92 of 95 schools reported.

#### Mean salaries for all basic science faculty (strict full time)

Year:	Mean salary
1963-64.....	\$13,806
1964-65.....	NA
1965-66.....	15,018
1966-67.....	15,996
1967-68.....	17,336
1968-69.....	18,230
1969-70.....	19,353
1970-71.....	19,765
1971-72.....	21,051
1972-73.....	21,972

<sup>1</sup> 59 percent over 1963-64.

#### Mean salaries for all ranks of clinical science faculty (strict full time)

Year:	Mean salary
1963-64.....	\$19,044
1964-65.....	NA
1965-66.....	20,096
1966-67.....	21,515
1967-68.....	23,688
1968-69.....	24,738
1969-70.....	26,407
1970-71.....	28,223
1971-72.....	30,008
1972-73.....	31,640

<sup>1</sup> 66 percent over 1963-64.

Source: Dr. John A. D. Cooper, Association of American Medical Colleges, One Dupont Circle, Washington, D.C.

<sup>2</sup> Source: "Economic Pressures on the Major Private Universities," William G. Bowen, reprinted from "The Economics and Financing of Higher Education in the United States," a Compendium of Papers Submitted to the Joint Economic Committee, Congress of the United States, Government Printing Office, 1969, pp. 399-439.

*Hospital Services*

A major program concern and site of W. K. Kellogg Foundation expenditures has been the hospital field. The Foundation has assisted a wide variety of programs in community hospitals such as in recent support for coronary care units and the improvement of burn patient care facilities and services.

The increase of such support by the Foundation has substantially paralleled the general rise of hospital costs in the United States. Such costs have risen at an appreciably greater rate than the general cost of living. The following is a depiction of the dramatic rise in hospital expenditures between the period 1950 to 1970:

TABLE 7.—TOTAL EXPENSES AND EXPENSE PER PATIENT DAY, COMMUNITY HOSPITALS, 1950-70

Year	Total expenses (in millions)		Expenses per patient day	
	Amount	Percent increase	Amount	Percent increase
1950.....	\$2,120	.....	\$15.62	.....
1951.....	2,314	9.1	16.77	7.3
1952.....	2,577	11.3	18.35	9.4
1953.....	2,867	11.2	19.95	8.7
1954.....	3,121	8.8	21.76	9.1
1955.....	3,434	10.0	23.12	6.3
1956.....	3,733	8.7	24.15	4.5
1957.....	4,160	11.4	26.42	9.4
1958.....	4,655	11.8	28.27	7.0
1959.....	5,091	9.3	30.19	6.8
1960.....	5,617	10.3	32.23	6.8
1961.....	6,250	11.3	34.98	8.5
1962.....	6,841	9.5	36.83	5.3
1963.....	7,532	10.1	38.91	5.6
1964.....	8,349	10.8	40.58	6.9
1965.....	9,147	9.6	44.48	7.0
1966.....	10,276	12.3	48.15	8.3
1967.....	12,081	17.6	54.08	12.3
1968.....	14,162	17.2	61.38	13.5
1969.....	16,613	17.3	70.03	14.1
1970.....	19,560	17.7	81.01	15.7
Average annual increase.....	.....	11.8	.....	8.6

Of the nearly \$14 billion rise between 1960 and 1970, the following factors have contributed:

## 1960-70—14,000,000,000 INCREASE IN TOTAL U.S. HOSPITAL EXPENDITURES

	Percent	Amount (billions)
Population changes.....	8.6	1.2
Increased patient usage.....	13.6	1.9
Inflation.....	20.0	2.8
Increased payroll.....	31.4	4.4
Increased supplies and materials.....	26.4	3.7
Total.....	100.0	14.0

The American Hospital Association has informed us that the estimated 1973 per diem cost for hospital care is \$102.37. This is in contrast to a similar cost of \$15.62 in 1950 and \$32.23 in 1960.

One example of rather marked escalation in the cost of program activities supported by the Kellogg Foundation in the health field relates to our recent grant to make possible a national study of education for health administration and as contrasted to an identical commission in 1952-54. The earlier commission covered a life span of two years with a professional staff complement of two members plus one secretary. The total cost of this national study and which was completely defrayed by the Foundation was \$71,199.

The Commission on Education for Health Administration was established in 1972 and its activity is scheduled to be completed by mid-1974. It has a similar purpose as the earlier group. The professional and secretarial complement is precisely the same, although there are some variables, such as complexity and

the growth of this field. It is striking that the Foundation's commitment to the present Commission now totals \$463,573.78.<sup>3</sup>

Hospital care has taken the largest share of increased spending on health. Since 1960, the cost of a day in a hospital has gone up 204%—to \$92 in 1972, on average. The charge may run up to 50% higher in large cities. Physicians' fees, now costing Americans 16.2 billions a year, are up 74% over the same span.

Hospital costs in Michigan have been rising faster than the cost of living since 1960, and particularly since the 1966 introduction of Medicaid and Medicare. From 1966 to 1971, Michigan hospital costs increased by 105.4% with 19.6% attributed to the increase in inflation.<sup>4</sup>

A REPORT PREPARED FOR THE AD HOC COMMITTEE ON SECTION 4942 BY  
NORMAN B. TURE, INC.

Acknowledgements

This report on The Impact of the Minimum Distribution Rule on Foundations was commissioned by the Ad Hoc Committee on Section 4942 to provide an objective analysis and evaluation of Section 4942 of the Internal Revenue Code. The report is focused on the impact of the 6 percent minimum distribution rule with respect to foundations' investment performance and their capacity to provide financial support for charities.

Throughout the preparation of this report, I have enjoyed the complete cooperation of the Ad Hoc member foundations in providing me data and other assistance. The member foundations are: Maclellan Foundation, Maclellan Trust, Lettie Pate Evans Foundation, Lettie Pate Whitehead Foundation, Joseph B. Whitehead Foundation, W. K. Kellogg Foundation, Pew Memorial Trust, Lilly Endowment, Kresge Foundation, Emily and Ernest Woodruff Foundation, and Hormel Foundation. (In the interests of preserving confidentiality, the data pertaining to these foundations are identified in this report by code letter in an order which does not coincide with the sequence shown here.) At no time, however, have the foundations or their representatives attempted to influence the substance of or the methodology used in preparing the report. The analysis, findings, and conclusions are those of Norman B. Ture, Inc.

I am deeply grateful for the expert assistance provided me by Mr. Kenneth D. Simonson and others of the staff of Norman B. Ture, Inc.

NORMAN B. TURE,  
President, Norman B. Ture, Inc.

THE IMPACT OF THE MINIMUM DISTRIBUTION RULE ON FOUNDATIONS

I. INTRODUCTION

Section 4942 of the Internal Revenue Code requires tax-exempt foundations to distribute to qualified organizations amounts equal to or greater than 6% of the market value of the foundation's assets. This requirement was enacted in the Tax Reform Act of 1969 ostensibly for the purpose of removing the uncertainties and vagaries of prior law under which foundations accumulating income in unreasonable amount or over an unreasonably long period might lose their tax-exempt status. This loss of tax-exemption was thought to be an inadequate threat to avert unreasonable accumulations in some cases and an excessively severe penalty in others. In addition, if a foundation invests in assets that generate no current income flow to the foundation, the unreasonable accumulation rule was, obviously, inoperative. In such cases, it was alleged that the donor of the foundation's assets might receive substantial tax benefits from his contribution, while charities might receive no current benefits, i.e., grants, from the foundations.

During the legislative development of those provisions of the Tax Reform Act bearing on foundations, a large number of issues pertaining to foundations, their role in the U.S. society, and their operations were raised. The focus of legislative deliberations was on efforts to correct alleged abuses by foundations and to

<sup>3</sup> Source: Andrew Pattullo, Vice President-Programs, W. K. Kellogg Foundation.

<sup>4</sup> Source: "Enquirer and News," Battle Creek, Michigan, Thursday, March 15, 1973.

circumscribe modes of operation deemed to be inconsonant with the public policy objectives sought in the tax exemption of these organizations.

Insofar as a minimum distribution rule is involved, the principal issue was whether the amount of distributions by foundations to charities was a sufficiently high return on the tax savings afforded those establishing the foundations. To this point, the matters that were raised during the hearings and in floor debate included the contentions that (a) the investment performance of foundations, i.e., the rate of return they realize on their assets, compares unfavorably with that of mutual funds; (b) in some, perhaps considerable part, this poor performance is attributable to undue concentration by a foundation of its assets in a single class of stocks of a single corporation; (c) in many cases, this investment policy by the foundation revealed that its real purpose was to afford continuing family control over the corporation rather than to provide financial support for charitable activities; (d) better investment performance would significantly augment the amount of distributions by foundations to charities; (e) better investment performance called for both more highly diversified and higher yield portfolios, and (f) imposing some relatively high minimum distribution requirement on foundations would effectively impel them to improve investment performance by diversifying their portfolios and increasing their yield, which by the same token would require them to relinquish concentration of asset holdings in a single class of stock in a single company, and which would result in their increasing their distributions to charity.

This report subjects these considerations advanced in favor of a minimum distribution rule to critical examination, both factual and analytical.

Clearly, the fundamental objective of any minimum distribution rule is to increase the amount of private financial support for charitable organizations and their activities. Whether such a rule would achieve any of the other objectives attributed to it is a secondary matter, if not indeed irrelevant.

The findings and conclusions of this report may be briefly summarized. First, any minimum distribution rule which ignores the foundation's rate of return will have a highly differential discriminatory and possibly capricious impact on foundations and on their long-term capacity to support charities. Second, the contention that the investment performance of foundations is relatively poor is based on inadequate information and inappropriate statistical measures; the record of the foundations for which data were available in the preparation of this report certainly does not support this contention. Third, no sound evidence was advanced to support the view that the allegedly poor investment performance of foundations is related to the concentration of their investment assets. Fourth, it is neither realistic nor reasonable to assume that a minimum distribution rule will result in significant increases in the rate of return on foundation investments. Fifth, an appropriate distribution rule should be based on the rate of increase in the amount of distributions desired by public policy, adjusted in the case of each foundation by the rate of return that foundation realizes on its investment.

Finally, the report concludes that the tax savings allegedly realized by those establishing foundations are, in all likelihood, very small. Foundation distributions to charity have represented a sizeable amount of benefits relative to the foregone revenues.

## II. PORTFOLIO INVESTMENT POLICIES OF FOUNDATIONS

One of the principal arguments advanced in 1969 in favor of some minimum distribution rule was that, relative to their total assets, foundations generally " . . . are not providing an adequate payout to society in return for the immediate tax deductions society has given their donors."<sup>1</sup> In turn, the allegedly too low distribution rate was related to an allegedly poor investment performance by foundations compared with that of mutual funds. While avowing that it had not exhaustively reviewed the investment performance of foundations (a caution neglected in the 1969 legislative discussions which relied heavily on its data), the Commission nevertheless asserted that " . . . the investment performance of foundations is below par, and perhaps significantly so. . . . Since each percentage point of added total return on foundation investments would yield between two and three hundred million dollars of additional funds for

<sup>1</sup> Commission on Foundations and Private Philanthropy, *Foundations, Private Giving, and Public Policy*, University of Chicago Press (Chicago), 1970, p. 76. The Commission and the report are referred to hereafter as "the Commission" and "Report," respectively.

charity, the cost to society of a lackluster management of these investments could be on the order of hundreds of millions of dollars annually."<sup>2</sup>

The issues raised in the Report and in the 1969 legislative discussions, although separately identifiable, are obviously interrelated. On the one hand, there is the issue of the type of assets held by foundations and of the yield per dollar of such assets, measured against some relevant performance standard. On the other hand, there is the issue of the disposition of the annual return on foundation assets, i.e., the allocation of that return between current year distribution to charities and augmentation of the foundations' future capacity to support charities.

Evaluation of the management of foundation investments is not merely a question of comparing the rate of return on foundation assets with that realized by other investors, say mutual funds. That evaluation must also include an assessment of the long-term objectives of foundations in support of charitable, educational, scientific, medical, etc., activities and of the overall portfolio and grant policies in the light of those objectives.

#### A. Return on foundation assets.

Testifying on October 22, 1969, before the Senate Finance Committee on H.R. 13270, Mr. Peter G. Peterson, then Chairman of the Commission, reported that one of the Commission's findings was that the *total rate of return* on foundation assets was materially lower than that of mutual funds. The total rate of return, asserted to be the performance yardstick commonly used by mutual funds, profit sharing and pension funds was defined as the sum of dividends, interest, realized and unrealized capital gains divided by the market value of the assets.<sup>3</sup>

Using this measure, the Commission's findings, based on a sample of foundations' forms 990A for the year 1968, are summarized in the following table:

#### *Total return on foundation assets as percentage of assets, 1968<sup>4</sup>*

Foundations with assets:	Median total return on assets percent
Under \$200,000.....	4.7
\$200,000-\$1,000,000.....	6.7
\$1,000,000-\$10,000,000.....	6.0
\$10,000,000-\$100,000,000.....	7.7
Over \$100,000,000.....	8.5
Company foundations.....	5.8
Community foundations.....	5.2
Weighted figure for all foundations.....	5.6

By contrast, the Commission found an annual average total return for the years 1959-68 for 21 balanced funds of 9.2 percent and for 10 large general growth funds of 14.6 percent. For 1968, the Commission cited an average total return of 15.3 percent for common stock mutual funds and of 14.9 percent for balanced funds.<sup>5</sup>

A number of aspects of these "findings" cast serious doubt on their interpretability and reliability. First, the percentages reported are median values, not weighted arithmetic means or averages. The Commission explained the use of the median figure as intended to help offset any disproportionate effects of those foundations which did not report assets at market value. For reasons explained below, any such foundations should have been eliminated from the calculation. Use of the median rather than mean does not bear on the bias introduced by the inclusion of data from such foundations. The median measure reported by the Commission for each size class identifies the total rate of return of that foundation with respect to which there were an equal number of foundations with a lower and a higher rate of return. But this measure

<sup>2</sup> Report, p. 75. The implications of the quoted statement are examined at a later point in this report.

<sup>3</sup> Cf. Report, p. 74.

<sup>4</sup> Report, p. 74.

<sup>5</sup> *Ibid.*



does not tell one how the foundations in that size class, taken together, performed. For example, suppose a size class consisted of 5 foundations each with \$1 million of assets, one of which had a zero total rate return (as measured by the Commission), one had returns of \$10,000 or 1 percent, one had returns of \$20,000—2 percent—and two had returns of \$200,000 each—20 percent. The median return "found" by the Commission would be 2 percent, although taken as a group, the five foundations had total returns of \$430,000 or \$5,000,000 of assets, or an average return of 8.6 percent.

In addition, the Commission apparently compared its *median* rate of return with a weighted *mean*—or average—return for the unidentified mutual funds to which the Report alludes. Suppose that the distribution of mutual funds by rate of return was identical with the distribution of foundations in the illustration above. Then comparing the *median* value of foundation rate of return with the *mean* value of mutual fund rate of return would come up with the "finding" that the mutuals had outperformed the foundations by 4.3 to 1, despite the fact that their respective performances were by hypothesis identical.

Moreover, as noted above, the inclusion of results based on book values for some foundations with market values for other foundations puts the "findings" of median rate of return quite beyond interpretation or analysis. Referring to the Commission's definition of total returns—the sum of dividends, interest, realized and unrealized capital gains—consider a foundation whose assets are reported per book rather than market values. Suppose the market value of the foundation's assets increase by, say, 15 percent from the beginning to the end of year, because the corporation whose stock constitutes the assets of the foundation has retained the full amount of its earnings. The appreciation in the market value of the stock of course reflects the market's capitalization of the increase in the corporation's future earnings which will flow from the retained earnings of the current year. But this market appreciation will not necessarily be fully or even substantially reflected in the book value of the stock held by the foundation. The computed total return on assets, relying on book values, may therefore fall materially short of that which would result from using market values.<sup>6</sup> Including measures of total rate of return based on book values, therefore, is highly likely to bias the Commission's findings downward from the actual total rate of return of the foundations. Moreover, it invalidates any comparison with the total rates of return realized by other institutional investors.

Finally, the Commission's "finding" that the investment performance of foundations is below par is based on the results of a single year's operation by the sampled foundations. The Report conceded that one year is not an adequate period for evaluating investment return;<sup>7</sup> nevertheless, this perfectly correct caution did not preclude the Commission from making a comparison of investment performance and from concluding on the basis of that comparison that foundation management of their portfolios was lackluster.

In contrast with the Commission's findings, which were the principal data source for legislative discussions in 1969, examination of the investment performance of several major foundations leads to the conclusion that these foundations were highly efficient in their investment management, at least as measured by the Commission's total rate of return. For foundations, the annual average rate of return from the time of first endowment through 1972 ranged from a low of 12.3 percent to a high of 21.5 percent.<sup>8</sup> For some of these foundations, to be sure, considerable fluctuations in total rate of return from year to year were experienced, but even so, the rate of return record of each over its lifetime has been impressive. Thus, the average annual total return, including dividends and appreciation in the market value of assets, computed as the compound interest rate of growth from the year of initial endowment through 1972, ranged from a low of 7.9 percent to a high of 17.2 percent.

<sup>6</sup> In fact, some of the foundations in the Commission sample reported no change in book value of assets on their Forms 990-A, although the market value of their assets rose significantly. While it is conceivable that book values might increase more than market values, this is far less likely to occur.

<sup>7</sup> Report, p. 74.

<sup>8</sup> Average, for each foundation, of the total rates of return for each year from initial endowment through 1972.

[In percent]

Foundation and year of endowment	Average annual total rate of return	Compound interest average annual rate of increment over market value of initial endowment <sup>1</sup>
A (1958).....	13.3	13.1
B (1957).....	12.3	12.0
C (1945).....	14.6	9.0
D (1954).....	21.5	17.2
E (1940).....	15.1	9.7
F (1935).....	13.9	7.9
G (1939).....	14.5	9.0
H (1924).....	14.9	9.1
I (1955).....	16.7	10.6
J (1948).....	10.0	8.0
K (1938).....	14.0	<sup>2</sup> 16.9

<sup>1</sup> Adjusted for additional contributions and stock splits.<sup>2</sup> Since 1952.

There are, in short, substantial grounds for skepticism about the Commission's "findings" of poor investment performance by foundations. It is regrettable that these "findings" and the conclusion drawn by the Commission from them were not subject to more critical examination in the legislative development of the Tax Reform Act of 1969.

#### *B. The appropriate measure of return for foundation distributions*

The minimum distribution rule of Section 4942 relates the required distribution by a foundation to the average market value of its assets. In this respect, the rule follows the reasoning advanced by the Commission with regard to the measure of the base against which foundation distributions should be evaluated.<sup>9</sup>

For purposes of the investment policies of households and businesses, choice among investment property depends on the potential gain in net worth afforded by the investment alternatives open to the investor. This gain in net worth is the sum of current income flows from the investment and appreciation in the market value of the investment assets. Thus, for purposes of evaluating the investment performance, the measure cited by the Commission is appropriate.

It does not follow, however, that gain in net worth as measured in the market place over given time period affords an appropriate basis for rules governing distribution policies.

Consider the case of a corporation with earnings in a particular year of, say, \$1,000,000, where its earnings are measured according to the provision of the Internal Revenue Code and Regulations. In general, earnings so measured will be equal to receipts from the company's operations less expenses. Earnings do not include the appreciation in the market value of the corporation's equity. Nor should they. If these unrealized capital gains were included in income for the year, gross double counting would result, since the capital gains are, for the most part, the market's capitalization of the increase in the company's future income.

Suppose the corporation retains the full amount of its earnings for that year. These retained earnings, prudently and effectively invested by the corporation, will produce an increase in the company's future income. The valuation in the market place to that additional future income will be reflected in an increase in the market value of the company's equity. But the unrealized capital gain can hardly be regarded as part of the company's income for that year.

For purposes of the accumulated earnings tax (Section 531-537), this retention of earnings may be deemed to represent an improper accumulation, and an additional tax may be imposed. But the accumulated taxable income on which the additional tax may be imposed is determined by reference to the corporation's taxable income (with certain adjustments), which does not include the company's unrealized capital gains, i.e., the increase in the market value of its equity.

The shareholders of this company will enjoy unrealized capital gains, assuming that they retain their stockholdings and the market value of their shares increases in some proportion to the company's retained earnings. These unrealized capital gains, however, are not included in the income of the stock-

<sup>9</sup> Report, p. 74.

holders, nor should they be, even though the appreciation in the market value of their shares increases their net worth. To include this appreciation in the shareholders' current year's taxable income would be to subject them to tax on the capitalized value of future income as well as on the future income itself as materializes over time.

A foundation as one of the shareholders of the corporation no more than any other shareholder realizes income by virtue of the increase in the market value of its shares of the corporation's stocks. For effective management of its operations, the foundation must be constrained by the income it receives on its assets, not by the increase in the market value of these assets. The imposition of rules, pertaining to its operations, which rely on changes in the market value of the foundation's assets, thus, subjects the foundation to constraints dissimilar from and far harsher than any others applied by the Internal Revenue Code to any other class entities.

For the reasons presented below, any uniform minimum distribution rule is likely to be at odds with public policy objectives concerning foundations and their financial support of charities. Apart from these considerations, a minimum distribution rule which relates required foundation distributions to the market value of foundation assets rather than to foundation income will almost certainly produce highly anomalous and disparate results among foundations.

The obvious case in point involves differences among foundations with respect to the liquidity of their assets and the current income flow these assets produce. Thus, a foundation with a substantial proportion of its assets in, say, a low payout, growth corporation may very well be required under the minimum distribution rule, to liquidate significant amounts of its assets, while another foundation with a substantial part of its assets in high payout, low yield shares in a slower growing company may be under no such constraint. In terms of investment performance and growth in capacity to provide financial support to charities, the first foundation may very well be highly superior to the second. The impact of the minimum distribution rule, however, is precisely contrary to the objectives articulated for it in this case. Indeed, if the first foundation's stock is that of a closely-held company for which little or no market exists, the foundation may be put into an impossible position with regard to both effective management of its investments and building the capacity to support charity.

Similar difficulties will arise where substantial amounts of the foundation's assets are in real estate on which the net cash flow is less than 6 percent of the market value of the property. The investment in this property may very well be superior to any alternative available to the foundation in terms of the Commission's total rate of return as well as in terms of building capacity for distribution to charities. Yet the minimum distribution rule might very well require the foundation to liquidate these assets and either to replace them with others which are inferior or to reduce permanently their capacity to support charity.

There is, as one might expect, substantial variation among foundations in their investment policies and asset composition. The minimum distribution rules of Section 4942 make no adequate allowance for these variations. The impact of Section 4942, therefore, is likely to be highly discriminatory. Moreover, since these differences in effects are not necessarily, if at all, in line with public policy objectives, the minimum distribution rule is likely to be highly capricious.

In some minimum distribution rule, imposed at a uniform rate on all foundations, is to be continued, it should be applied with respect to foundation income, not foundation assets.

#### *C. Investment performance and portfolio concentration*

One of the explanations offered for the allegedly poor investment performance of foundations, according to the Commission, is that ". . . a significant portion of a foundation investment portfolio is often control stock in a company."<sup>10</sup> Regrettably, the Commission provided no data showing the number or proportion of foundations whose portfolios were highly concentrated nor did it attempt to correlate foundations' rate of return experience with the degree of portfolio concentration.

The Commission did, however, provide some data, drawn from its 1968 sample of foundations, bearing on the distribution of foundation assets by type of asset. Excluding the Ford Foundation, the Commission found that stock in a company in which a donor and his family owned a controlling interest (20 percent or more

<sup>10</sup> Report, p. 75.

of the total issued) constituted 30 percent of total foundation assets. Appreciated real property was 4 percent of the total, other appreciated intangible property was 36 percent, while cash or unappreciated property was 25 percent. The proportions differed somewhat depending on the foundation size class; for foundations with over \$100 million of assets (excluding the Ford Foundation) control stock was 56 percent of total assets, compared with 19 percent for foundations with total assets less than \$200,000. Moreover, the Commission found, only 14 percent of the sampled foundations had received half or more of their contributions in control stock.<sup>10</sup>

The view that the allegedly poor investment performance of foundations results from the lack of adequate portfolio diversification is without substantiation. Appropriate data, if available, might indeed reveal a correlation between rate of return and degrees of diversification, but as matters stand, such correlation is pure conjecture.

Quite a different surmise emerges from examination of the investment performance of the foundations shown in the table above. In each case, the foundation's assets are highly concentrated in a single class of stock. The wide range of average rates of return among these foundations argues strongly that, at least in their case, rate of return is not correlated with portfolio diversity.

Some significant degree of portfolio diversification may be a valid general prescription for balancing yield and risk. It does not follow, however, that the diversification appropriate for one investor is equally appropriate for any other. Diversification per se is not an investment objective to be blindly or slavishly pursued in disregard of the rate of return experience of existing portfolios. Changing portfolio composition entails the costs of acquiring information on other investment assets and, generally, some transaction costs. It is by no means clear that any of the foundations shown in the table above could reasonably expect by diversifying their portfolios to improve their investment performance sufficiently to warrant incurring the costs such diversifying would require.

#### *D. Distribution policy and rate of return*

More fundamentally, the relevance of foundation investment performance to the desirability of a minimum distribution rule is obscure. Surely the occasion for a minimum distribution rule is not to improve foundations' investment management, in and of itself. A tax provision aimed at such a result for foundations would be highly discriminatory, since no other provision of the Internal Revenue Code bearing on any other class of entities is endowed with a similar intent. The purpose of a minimum distribution rule, rather, is to increase the amount of foundations' distributions to charities. Any such increase currently or in the near future will occur at the expense of less capacity by foundations than they otherwise would have to provide such support over the longer term unless foundations are able sufficiently to increase the rates of return on their investments. If it is desired to increase distributions currently or in the near-term and if the amount of the increase in distributions is relatively large, a minimum distribution rule designed to achieve this result will require large-scale inroads on the existing assets of foundations, the effects of which on future total returns and distributions capacity will far outweigh any increase in rate of return that might be realized by changes in foundation portfolios.

To the extent that public policy calls for a continuing and growing distribution capacity by foundations over the long term, a minimum distribution rule is counterproductive, irrespective of the total rate of return on foundation assets. The higher the required minimum distribution rate, the greater the likelihood of required reduction in foundation corpus, the effect of which on long-term distribution capacity is likely to outweigh by far any increase in rate of return which may be realized by changing the composition of the remaining corpus.

This may be illustrated by a hypothetical example. Suppose a foundation's initial endowment was \$1,000,000, which was invested at an annual interest rate of, say, 15 percent, and suppose the foundation's annual distributions were 1 percent of its assets. At the end of 10 years, it would have distributed a total of \$386,800, roughly, and would have accumulated total assets, i.e., distribution capacity, of about \$3,658,750. If the foundation had been required to distribute each year 5 percent of its accumulated principal at the end of each year, the accumulated principal at the end of 10 years would be about \$2,482,240, about \$1,238,510 less. Distributions of \$1,623,310 during the first 10 years instead of

<sup>10</sup> Report. Tables A31-33, pp. 243-245.

\$386,800 would reduce distribution capacity over the succeeding 10 years by about \$5,002,400 or by roughly 4 times the additional distributions in the first 10 years. In order to distribute each year 5 percent of the accumulated principal at the end of each year and to achieve the same distribution capacity at the end of 10 years as if annual distributions were 1 percent of assets, the initial principal would have to be invested at an interest rate of 19.84 percent, 32.3 percent greater than the assumed actual rate of 15 percent.

With a 6 percent minimum distribution rule, distributions totaling \$1,866,560 would be required in the first 10 years, resulting in accumulated assets of about \$2,179,000 at the end of 10 years. Distribution capacity for the succeeding 10 years would be reduced by roughly \$7,550,000. To avert this loss in distribution capacity, the initial endowment would have had to have been invested at a rate of return of 21.1 percent, about 41 percent more than the assumed actual rate of 15 percent.

If the foundation's rate of return were 10 percent, instead of 15 percent, requiring it to increase its distribution rate from 1 percent to 5 percent would result in additional distributions of \$792,760 over the first 10 years, but would reduce the accumulated distribution capacity over the next 10 years by \$1,860,000, roughly. A 6 percent minimum distribution rule would require \$948,700 in additional distribution in the first 10 years but would reduce distribution capacity in the succeeding 10 years by about \$2,225,000. To avert this loss in distribution capacity, the rate of return on the foundation's assets would have to increase to 14.6 percent and 15.85 percent, or by 46 percent and 58.5 percent, respectively.

Quite clearly, increase in rates of return of these magnitudes are hardly likely to be attained by even the most active and speculative investment management. Any minimum distribution rule which in practice requires foundations to increase the rate of their payouts to charities cannot realistically be justified as intended to improve the investment performance of foundations. On the contrary, the justification for any such rule must be the value judgment that the benefits from an increase in current distributions outweigh the cost of the reduced distribution capacity for the longer term.

#### *E. Distribution policy criteria*

For the long term, an appropriate distribution rate for any foundation must depend both on the desired rate of increase in its distributions and on the rate of growth of its distribution capacity, as well. Unless a fixed time horizon is placed on charities' requirements for financial support, or unless it is desired to substitute government financial support for private sources, the distribution rate required of foundations must take into account the impact of current and near term distributions on the capacity of foundations to provide the desired distribution in any future year. The higher the desired rate of growth in distributions relative to the rate of growth of assets, the lower must be the annual distribution rate if the foundation is to be able to meet its long term commitments.

The present 6 percent minimum distribution rule obviously does not take these considerations into account. For a great many foundations, it will require a sharp deceleration in the growth of their distributions. And for any foundation with a rate of return less than 6.5 percent, it will result in reduction and eventual exhaustion of assets and an absolute decline in the amount of distributions.

The following table shows the maximum rate of growth in the amount of foundation distributions, given alternative rates of return, under the 6 percent minimum distribution rule. For any foundation with a rate of return of, say, 10 percent whose distributions to charity have been growing at a rate faster than 3.4 percent, the 6 percent minimum distribution rule will require a cut back in the rate of expansion of distributions. Moreover, this cut back in the rate of growth of distributions is not a hypothetical matter. Every one of the foundations shown in the table below will be required to slow the increase in its distributions as a result of the 6 percent minimum distribution rule. In most cases, the required reduction in the rate of growth will be substantial.

Rate of return :	Maximum rate of growth in amount distributed (percent)
7.5 percent.....	1.05
10.0 percent.....	3.40
11.7 percent.....	5.00
12.5 percent.....	5.75
15.0 percent.....	8.10

Foundation	Actual rate of growth of distributions	Percent reduction in rate of growth of distributions
A	15.7	59.9
B	14.9	64.2
C	9.9	71.7
D	12.9	20.9
E	7.6	59.2
F	2.8	50.0
G	16.5	84.8
H	10.4	75.0
I	7.2	79.2
K	11.4	13.2

In all but two cases, the 6 percent minimum distribution rule will result in reductions in the distribution growth rate of well over 50 percent. In fact, the smallest reduction is 21 percent.

For all foundations, the average annual rate of increase in distributions to charities over the years 1955-1971 was about 10.2 percent.<sup>11</sup> The 6 percent minimum distribution rule, applied across the board, may very well reduce this growth rate to 5 to 6 percent.

These consequences of the 6 percent minimum distribution rule clearly are grossly at odds with the ostensible objective of the rule, viz., to impel foundations to *accelerate* the growth in their distributions. There is a broad consensus that the needs of charities for private financial support are expanding at an accelerating rate,<sup>12</sup> clearly implying that the desired growth rate of foundation distributions to charities over the next decade and a half should exceed that of the decade and a half from the mid-1950's. And indeed, it must be this persuasion that is the basis for the public policy position that foundations should increase their distributions to their recipient charities. But the minimum distribution rules of Section 4942, as demonstrated, are contraproductive to this end, when account is taken of the facts of foundations' distributions and earnings.

Any uniformly applicable minimum distribution rule, therefore, will discriminate severely among foundations, not in line with objectives of public policy but on the basis of factors over which public policy has little control. As shown about, these discriminatory effects of a minimum distribution rule cannot reasonably or realistically be justified as impelling foundations to manage their investments more efficiently.

#### F. Investment performance and distributions

The Commission contended that improved investment performance by foundations would result in increases in distributions to charities,<sup>13</sup> and this assumption was repeatedly articulated during the legislative hearings and debates. A minimum distribution rule, as already noted, was widely viewed as impelling foundations to improve their investment performance. Presumably, any increase in investment returns resulting from this improvement would be immediately passed on in additional distributions to charities. To complete the syllogism, by requiring foundations to improve their investment performance, a minimum distribution rule would result in additional distributions to charity.

Interestingly enough, this line of reasoning is the reverse of the justification for a minimum distribution rule based on the view that foundations were not distributing enough of their earnings. The clear implication of the latter view is that given their rate of return, foundations could well afford to increase their distributions.<sup>14</sup>

The Commission's reasoning and much of the legislative discussion appears to be excessively mechanistic, ignoring a host of considerations which enter into foundations' determinations of the amount of their distributions. In the first place, as the discussion above demonstrates, full distribution of any increase in earnings resulting from an increase in rate of return would not conform with the condition that the foundation should be able to meet any future, targeted distribution. Beyond this observation, however, foundation distribution policy is also

<sup>11</sup> *Statistical Abstract of the United States, 1972, Table No. 499, p. 306, from American Association of Fund Raising Counsel, Inc., Giving U.S.A.*

<sup>12</sup> Cf. Report, Chapter 3 and Appendix II, 1.

<sup>13</sup> Report, p. 76.

<sup>14</sup> Congressional Record, December 6, 1969, pp. S15959-15963.

guided by considerations of the specific charitable activities which the foundation wants to support, the present demands of such charities relative to those which may be reasonably anticipated at a future date, the capacity of the donee effectively to utilize additional grants currently compared with their use at a later date, and so on. The balance among these and numerous other considerations dictate efficient distribution policy.

To be sure, the foundation's rate of return sets a limit on distributions, at least over a period of years. But it certainly does not follow that an increase in rate of return either would or should be promptly reflected in an equal increase in distributions. Moreover, if account is taken of the variability in investment return experience, on the one hand, and of the much steadier increase in charities' demands for financial support over the long term, and the extended time period of many grants, on the other, prompt year-to-year change in response to changes in rate of return would be neither practicable nor desirable.

Over the long term, increases in foundations' rates of return should be expected to result in increases in distributions, based on extrapolation of historical experience. But this historical relationship does not afford the basis for contending that a minimum distribution rule of the sort now in the law will impel an increase in distributions over the long term by virtue of an improvement in foundations' investment performance.

### III. FOUNDATION DISTRIBUTIONS AND DONOR TAX SAVINGS

As noted above (section II), one of the major inputs into the 1969 revisions of the tax provisions pertaining to foundations appeared to be the view summarized by the Commission in its assertion that ". . . foundations . . . clearly are not providing an adequate payout to society in return for the immediate tax deductions society has given their donors."<sup>15</sup> At issue is (1) the magnitude of the revenue loss sustained by the Treasury by virtue of the deduction of donors' contributions to foundations and by virtue of foundation tax "exemption", and (2) the comparison of returns which might be expected from the Government's use of the foregone revenue with the foundations' distributions to charities.

Clearly, if it were shown that the magnitude of the tax savings from the deductibility of contributions to foundations is small, or if given the amount of savings it could be shown that the aggregate flow of benefits from the Government's use of the foregone revenue was exceeded by the amount of foundation distributions, the view that foundation payments were inadequate to justify the tax "benefits" would be unwarranted.

#### A. Amount of Tax Benefits

Net tax savings to donors, hence revenue losses to the Treasury resulting from the income, estate, and gift tax deductibility of contributions to foundations are in all likelihood quite small in magnitude. Close estimation of these tax savings is not feasible, primarily because of the inadequacy of data pertaining to such contributions. It is hardly surprising, in view of these difficulties, that the Commission did not support the quoted statement with a comparison of foundation payout with their donors' tax savings.

According to the Commission, the market value of foundation assets in 1968 was between \$20 billion and \$30 billion.<sup>16</sup> If one were to assume that the average age of the foundations in 1968 was, say, 15 years, and that the average rate of increase in the market value of foundation assets has been, say, 7 percent, then the value of the foundations' assets at the time they were contributed to the foundations would have been between roughly \$7.25 billion and \$10.88 billion. The tax benefits resulting from these contributions, of course, would have varied substantially, depending on when they were made, the tax deduction allowed at the time, and the applicable tax rate. But suppose that on the average, the contributions had been fully deductible and at a tax rate of, say 50 percent. Then the tax savings to the donors and the revenue loss to the Treasury would have been of the order of \$3.6 billion to \$5.4 billion.

Alternatively assume that the average age of foundations in 1968 was, say, 25 years and that the average rate of growth in the market value of the assets was, say, 15 percent. On these assumptions, the value of the assets at the time they were donated to the foundations would have been between roughly \$600 million

<sup>15</sup> Report, p. 76.

<sup>16</sup> Report, p. 151.

and \$900 million. With an assumed marginal tax rate of 50 percent, the deductibility of these donations provided tax savings of between \$300 million and \$450 million.

Given the wide range of the estimated age and rate of growth of the assets of foundations and the lack of data pertaining to donor's tax situations at the time of donations, any estimates of the actual amount of the tax savings is subject to an extremely large margin of error. Merely for illustrative purposes, however, assume that the tax benefits, hence Treasury revenue loss, were of the order of magnitude of \$2 billion. Further assume that the average age of foundations, consistent with this estimate of tax savings, is 20 years (as of 1968).

*B. Comparison of Foundation Distributions With Government Use of Tax Savings*

On these assumptions, one might ask, "What would have been the cumulative amount of "benefits" to society if no deductions had been allowed and if the Government had distributed 6 per cent per year of its returns on the \$2 billion of additional revenues, assuming that these returns were equal to 6 per cent per year of the net-of-distributions amount of the \$2 billion of revenues? How does this cumulative amount of Government benefits compare with the cumulative amount of foregone foundation distributions, given the actual rate of growth of such distributions?"

Given these assumptions, Government benefits distributed to society in amounts equal to the earnings on the \$2 billion of additional revenues would have aggregated roughly \$2.9 billion from 1948 through 1972. If donors had not been allowed to deduct these contributions, and if their donations to foundations had been less than assumed above in an amount equal to the additional taxes they would have paid, then the cumulative amount of foregone distribution by foundations to charities from 1948 through 1972 would have been roughly \$11.3 billion.<sup>17</sup> Even if the foregone foundation distributions had been only half as much—\$5.6 billion—as estimated, and if the Government's use of the additional tax revenues had provided half again as much additional benefits—\$4.4 billion, it is clear that the lost foundation distributions would have substantially exceeded the additional benefits from Government.

Granting the imprecision of these calculations, they nevertheless strongly urge that there is little factual justification for the notion that foundation payouts have been an inadequate return to society for the tax deductions society has given their donors. Indeed, relatively few government spending programs could meet the benefit-cost standards implied by foundation distributions in relation to tax savings to the donors of foundations' assets.

Senator FANNIN. F. Lee Jacquette, Treasurer of Carnegie Corp. of New York and the Carnegie Foundation for the Advancement of Teaching, will be the final witness today, and Mr. Jacquette, you have been very, very patient and we appreciate very, very much that you are still with us at this late hour.

**STATEMENT OF F. LEE JACQUETTE, TREASURER,  
CARNEGIE CORP. OF NEW YORK**

Mr. JACQUETTE. Thank you for the opportunity to speak on the impact on foundations of distressing economic conditions. I have four summary points and I would then ask the committee's indulgence in elaborating briefly on two of them.

First, as we have heard today, severe declines in stock and bond prices have very seriously eroded the ability of most foundation asset portfolios to do the philanthropic job they are designed to do, and high rates of inflation have further compounded the difficulties of meeting the Nation's philanthropic needs.

<sup>17</sup>This assumes that the initial foundation distributions in 1948 would have been half the amount estimated for that year and that distributions would have increased at the same average annual rate—10.1 percent—as over the years 1955-1971.



Second, reduction or total elimination of the 4 percent excise tax on foundation income would immediately enhance the ability of foundations to meet philanthropic needs. —

Third, the 6 percent minimum investment return established by the Tax Reform Act overstates the real return, the return adjusted for inflation that has, in fact, been earned over long periods of history in diversified portfolios in most capital market instruments.

Our suggestion is that a statutory ceiling of 5 percent on the payout rate would enable foundations to meet charitable needs currently and preserve sufficient purchasing power to permit them to do it again in the future.

Senator CURTIS. May I ask a question right there?

Mr. JACQUETTE. Certainly.

Senator CURTIS. If a foundation must go into its corpus to meet the mandatory payout requirements, it is entirely likely that many of them will have to sell securities at a very depreciated rate, depreciated market value.

Is that not right?

Mr. JACQUETTE. Yes, if the portfolio were so constructed that a high proportion of its total return came from capital gain rather than from current income. There would be and there are, as has been pointed out, foundations which produce the full current minimum investment return in the form of cash income, so that what you say does apply to foundations which would need to invade corpus to meet the minimum distribution requirements; yes.

Senator CURTIS. Well, I am directing my question to those that would have to invade a corpus. There is quite a likelihood that they, in order to meet that requirement, would have to sell assets on a very low market. —

Is that not right?

Mr. JACQUETTE. At unfavorable times.

Senator CURTIS. Yes.

Mr. JACQUETTE. That is correct.

Senator CURTIS. Which has an impact upon the future earning power of the foundation and the amount of their endowment for the future.

Mr. JACQUETTE. Yes, and that has been stressed in some of the testimony given here. It is our feeling that foundations do have a responsibility to behave in a mildly counter-cyclical manner, though, so that moderate invasion of corpus at a time of severely depressed securities prices may make sense for some foundations because just at the time that the circumstances of the foundation's financial affairs are most distressing, the needs of charity tend to be most pressing.

Senator FANNIN. How would you recommend that the foundation have that flexibility?

Mr. JACQUETTE. To provide the foundation—

Senator FANNIN. Well, you said it would be a sacrifice to sell at certain times, because of the falling market.

Mr. JACQUETTE. Yes.

Senator FANNIN. How would you give that flexibility, so that they would not need to do that?

Mr. JACQUETTE. Well, I would say that is being balanced by selling securities at far higher prices to meet the distribution requirements, if required in times of plenty.

Senator FANNIN. Well, that is all I am trying to establish; how the flexibility could be given, and to get a better understanding of your intent.

Mr. JACQUETTE. My vantage point is a long-term vantage point, recognizing full well that in any one year, or one full business cycle, there would be sacrifices made, but that those sacrifices could be recouped in large measure—or in some cases entirely—on the next upswing in stock and bond prices, if and when that comes.

Senator FANNIN. But it would necessitate a change of the payout in any one year, would it not? I mean, in other words, it could necessitate—

Mr. JACQUETTE. In dollars, but not as a percentage, in that this suggestion is that 5 percent be established as a minimum investment return, or current cash yield, whichever is higher, preserving the principal features of existing legislation, but modifying the 3 percent figure and making it 5 percent; and removing from the Treasury the option of altering that figure to reflect current market developments, because they are so volatile. And that is one of the points that I would like to come back to, briefly.

The fourth of my summary points is that the minimum level of charitable distribution is eminently sensible, but the particular wording of the Tax Reform Act and/or the bind that it has placed the U.S. Treasury in does require modification, and that this modification would take a legislative move. As is the case in the Ford Foundation, Carnegie Corp. does external comparisons of its investment performance, and that performance in absolute terms has been miserable, although in relative terms it has been respectable. But 10 years ago, the Corporation did hold assets worth \$331 million. Today, they are worth about \$227 million, and during that time, there have been only moderate invasions of corpus. About \$21 million has been spent in realized capital gains.

We estimate that the price index for the human services that we support rises about 7 percent per year, and that this is the inflation rate that we have faced in the past decade. So that in real terms, adjusted for that 7 percent inflation rate, the purchasing power of the \$227 million in today's endowment is only 34 percent of the purchasing power of the \$331 million that we held in assets 10 years ago. So this has been a sharp and steep erosion in our view, and it is our hope that this has been a typically difficult decade; and we do come to the conclusion that, in addition to the moderate effect of reduction or elimination of the excise tax, a recasting of the minimum investment return, freezing the figure at 5 percent, would still give us a chance long term to preserve the real purchasing power of assets, and provide—as is the concern of this committee and of others who have testified today—a respectable rate of payout to charity.

I said earlier that the Treasury is in a practically impossible bind in administering the wording of the act; the act does refer to money rates and investment yields, and yet investment yields are not specifically defined. The legislative history suggests that investment yields are total returns, but that is not clear from the wording of the act. Money rates are ordinarily defined to mean interest rates on securities maturing within 1 year. The Treasury, in fact, is using neither money rates, which are short-term rates, nor investment yields, par-

ticularly if one construes them as total returns on long-term bonds, long-term mortgages, long-term equity commitments.

The difficulty is the comparison of the one base year, 1969, to subsequent single base period years, and as has been pointed out in the Treasury memo, if investment yield is defined simply as cash yield, current ordinary income, then implementation of the act, in using the 5 year Treasury note rate, has produced a somewhat lower minimum investment return than would otherwise have been the case. But if it had gone to one of the alternatives—that is, to look at total return and a balanced portfolio approach more representative of portfolios as they exist in the real world of foundations, pension funds, and other managed pools of money—the applicable percentage would have fluctuated very widely, if not wildly.

For example, in a hypothetical portfolio consisting one-quarter of Treasury bills, one-quarter in long term bonds, and one-half in the Standard and Poors 500 stock index, if we had looked at the current cash yield on the T-bills, and the total return on the long bonds and the stocks, we would have gotten total rates of return of minus 5 percent for 1969, plus 12.4 percent for 1972, minus 5.4 percent for 1973, and an approximation, because the year has not yet ended—about minus 16 percent for 1974. The minus figures, of course, occur because the positive income yield on the T-bills and the positive yield on dividends on stock and interest on long term bonds is more than swamped by the price depreciation in long bonds and in equities we have experienced over much of the past 5 years.

So that the suggestion I make is that present law be amended to require private grantmaking foundations to dispense, for their purposes, the higher of their cash return for the year, or 5 percent of the average of the month-end value of their assets in the preceding year. And I suggest preceding year rather than the current year, to facilitate planning for resource allocation at foundations. The current applicable percentage applies to asset values during the current year, and yet it is not until the current year is complete that one knows what one's average asset values have been.

Alternatively—and preferably, in my view—one would average 2 or 3 years of asset values, and then apply the applicable percentage to it. In the case of Carnegie Corp., as is illustrated by the press release attached to my formal statement, this does have the effect of introducing a mild countercyclicality into the behavior of our grantmaking. It has enabled us to maintain grants at a dollar level close to what they were last year and during the preceding year; whereas if we looked only at current asset values, there would be grave reluctance on the part of the staff and the trustees to make allocations which would be a very high percent of very depressed current market prices.

So, in sum, we entirely endorse the notion of the minimum investment return, but we feel there are technical defects in the precise wording of the act which have made it extraordinarily difficult for the Treasury to provide operational guidelines that are sensible in the long run.

Senator FANNIN. Thank you very much. Your entire statement will be made a part of the record, and your elaboration will also be a part of the record.

If there are any questions—you have done extremely well in covering the subject, and your opinions in these matters—if there are any questions by any members of the committee, I trust that you would respond in writing.

Mr. JACQUETTE. Yes, I would, Senator.

Senator FANNIN. Again, my thanks for your patience and understanding, and I certainly appreciate that you have furnished this information, which is going to be very helpful. And I just trust that we will be able to come to some decisions based on the splendid testimony we have had today.

Thank you.

Mr. JACQUETTE. Thank you.

Senator FANNIN. The hearings will stand in recess until 9:30 tomorrow.

[The prepared statement of Mr. Jacquette follows:]

PREPARED TESTIMONY OF F. LEE JACQUETTE, TREASURER OF CARNEGIE CORPORATION OF NEW YORK AND THE CARNEGIE FOUNDATION FOR THE ADVANCEMENT OF TEACHING

I am treasurer of Carnegie Corporation of New York, one of the nation's larger grant-making philanthropic foundations, and of The Carnegie Foundation for the Advancement of Teaching, a separately-endowed smaller foundation which operates its own programs in higher education rather than carry out its purposes by making grants to others. In response to the request of this subcommittee, I am pleased to make the following observations about Carnegie Corporation and the effects of general economic and financial problems on the Corporation and, by extension, on other grant-making foundations.

Ten years ago, Carnegie Corporation held investment assets with an aggregate market value of \$331 million. Today, the Corporation's investment assets are worth approximately \$227 million. During the past decade, the Corporation expended \$148 million for its charitable purposes (including program management, general administration, and other administrative costs of \$15 million). Since 1969, the Corporation also incurred costs of almost \$2 million for the federal excise tax on investment income. Total charitable expenditures of \$148 million included all cash income earned plus \$21 million in realized capital gains. These distributions exceeded moderately the minimum investment return established by the 1969 Tax Reform Act.

Carnegie Corporation has long hoped to maintain the real purchasing power of its capital fund while providing rising donations to further its philanthropic purposes. Over the past decade, it has clearly failed in the former while succeeding modestly in the latter. Grant payments rose from \$13 million ten years ago to \$15 million in fiscal 1974. The erosion of the capital fund, however, was \$104 million. In recognition of the rates of inflation faced by our grant recipients—primarily educational and research institutions and organizations—the shrinkage in the real purchasing power of our capital has been significant. Our estimates indicate that the "price index" for the human services we support has risen about 7% per year in the past ten years. This means that in real terms, adjusted for the inflation rate in services we support, the purchasing power of our \$227 million endowment fund today is only 34% of the purchasing power of our \$331 million in assets ten years ago.

Carnegie Corporation, with a thoroughly-diversified portfolio of equities and fixed-income securities, has achieved creditable investment performance during this ten-year period. Periodic comparisons with external indicators show that the total return on our investment portfolio has been above average for managed pools of money. The serious erosion in the portfolio's purchasing power is, consequently, due to distressing investment performance in capital markets in general, to sustained high rates of inflation, and to our policy of paying out moderate amounts of realized capital gains in addition to all cash income received.

In recent months we have tried hard to maintain the dollar level of our grant-making activities. But only through exceptional invasion of capital could we have maintained the purchasing power of such expenditures. To our consternation, 1974's severely depressed securities prices convinced us that we would have

to throttle back on the absolute level of charitable giving if we were not to further rapidly deplete our resources in this generation at the expense of our ability to make grants for future generations.

This subcommittee has expressed concern over the diminution of private foundation resources at a time when federal and state government expenditures for many human welfare programs are being curtailed. I have two specific suggestions for helping to ensure a continuing stream of foundation grants over the intermediate and long-term future. Both involve legislative remedies.

First, I respectfully suggest that the excise tax on the investment income of foundations be eliminated or reduced. The 4% excise tax substantially exceeds the costs to the Internal Revenue Service of supervision of private foundations and other exempt organizations and shifts to general governmental revenue funds which otherwise would be available for philanthropic purposes in the private sector. It is gratifying that this subcommittee is on record as favoring a reduction in the tax. This clearly makes great sense, at least as an interim measure, because foundations would by federal law have to distribute to philanthropy any savings arising from a reduction in the tax.

Second, it would make sense to re-cast the minimum investment return provisions of the Tax Reform Act of 1969. Present law sets the "payout" level for private grant-making foundations at the higher of (1) adjusted net income or (2) an "applicable percentage" of the market value of investment assets during each foundation's fiscal year. The applicable percentage required by the Tax Reform Act is 6%. It is subject to annual revision by the Secretary of the Treasury based on the relationship of "money rates and investment yields" in the immediately preceding year to money rates and investment yields in calendar 1969. The Treasury, in response to the law, has modified the applicable percentage three times. First, the percentage was reduced to 5½%. Second, it was moderated further, to 5¼%. Third, it was boosted to 6%. The variations in the applicable percentage do raise questions about the administration of this feature of the law. Apparently, the Treasury has relied heavily on cash yields on intermediate-term U.S. Government securities. This procedure seems somewhat inadequate in carrying out Congressional intent that both "money rates" and "investment yields" be taken into account ("money rates" are ordinarily identified as interest earnings on short-term money market instruments such as Treasury bills or bank certificates of deposit; "investment yields" ordinarily refer to returns on stocks, bonds, and other long-term capital market securities). Consequently, the Treasury might well examine returns on balanced portfolios in establishing the applicable percentage. Nonetheless, as outlined below, the emphasis on comparisons of one year periods to the single base year of 1969 is simply not an optimum approach, even if the focus shifted from intermediate Government securities to the balanced portfolios found in the real world of investment management.

There is substantial evidence that the intent of the Congress was to define "investment yields" as *total* returns, i.e., interest, dividends, rent, and royalties, plus capital appreciation in asset values or less capital depreciation in asset values. To the extent one takes into account total returns on the principal classes of capital market instruments (common stocks and long-term bonds) the returns have been extremely volatile from year to year. Had such total returns on capital market investments been accorded any substantial weight in the Treasury's formulation, the applicable percentage would have fluctuated widely, if not wildly. For example, in a hypothetical portfolio consisting of ¼ Treasury bills, ¼ long term bonds, and ½ Standard & Poor's 500 stocks, the total rate of return would have been -5.0% for 1969, +12.4% for 1972, -5.4% for 1973, and about -16.0% for 1974.

The wording of present law focuses attention, regardless of how one defines "money rates or investment yields," on comparisons of *one year* periods to the *single base year of 1969*. This seems to me to lie at the center of the difficulties in the provisions of present law with respect to the minimum-investment return. There has been in the past, and presumably will be in the future, material variability in yields, rates, and total returns from year to year. However, the evidence is persuasive that, *over extended periods of time*, there is one remarkably consistent pattern: major capital market instruments yield between 4½% and 5% in real terms (adjusted for the rate of inflation). Consequently, I suggest that present law be amended to require private grant-making foundations to disburse for their charitable purposes the higher of their cash return from investments for the year or 5% of the average of the month-end value of their assets in the preceding year. Alternatively, a two or three-year moving aver-

age could be employed advantageously (see the attached copy of Carnegie Corporation's press release issued on October 11, 1974). I suggest the preceding year or more rather than the current year to facilitate planning and resource allocation at the foundations themselves. I suggest 5% because, assuming long-run past relationships between gross investment returns and inflation rates hold true for the future, this percentage gives foundations the opportunity to contribute significantly to *current* philanthropic needs and come close to or succeed in preserving the real purchasing power of their remaining assets to meet *future* philanthropic needs.

In short, I do not advocate alteration of the basic concept of a minimum level of charitable giving by private foundations. But I do believe there is room for improvement in the method of calculating appropriate levels of giving.

[For immediate release]

**NEW YORK.**—The trustees of Carnegie Corporation of New York, citing recent declines in the asset values of the foundation, announced yesterday a new policy governing budget authorizations for grants. The policy has been approved in recognition of the severe financial pressures faced by educational and charitable institutions to which it makes grants and therefore of the need to maintain the foundation's appropriations at the highest levels consistent with prudent administration of investment resources.

The policy involves the establishment each year of an annual ceiling for total appropriations and expenses of between 5.0% and 5.5% of the average market value of investment assets during the *prior* three years. According to F. Lee Jacquette, treasurer of the foundation, the regular use of the three-year moving average in conjunction with this payout percentage will have the effect of "cushioning the harmful impact of fast inflation and falling asset values generally characteristic of the endowed non-profit organizations and institutions in American life today. When securities are depressed, as they are now, the averaging technique permits expenditure for grants at higher levels than would be the case if only very recent asset values were considered. The reverse, of course, will be true when securities sell at higher prices, so that the foundation will tend to conserve resources somewhat in time of plenty."

Carnegie Corporation trustees have authorized approximately \$15.8 million for grants for the current year beginning October 1, 1974, a reduction of about \$500,000 from the amount actually devoted to grants the previous year. This relatively mild decline during a period of serious erosion in asset values during the last year from \$336 million to about \$210 million reflects the "countercyclical" effect of the averaging technique. Also, in anticipation of a cutback, about \$1 million was put aside from the 1973 grants authorization to carry forward for use in this or future years.

Alan Pifer, president of Carnegie Corporation, cautioned, however, of the probability of greater cuts in grant authorizations in 1975 and 1976, in part because there will be less likelihood of a carry-forward of unspent funds but primarily because depressed securities prices of recent periods will weigh more heavily in the three-year average.

"The significance of these reductions," said Pifer, "is that a number of important and useful programs pursued by the educational institutions will either be funded at less than the proposed amounts or will not be funded at all. The nation will be the poorer for it."

Carnegie Corporation of New York was founded in 1911 by Andrew Carnegie for the advancement and diffusion of knowledge and understanding among the people of the United States and certain Overseas British Commonwealth countries. Its assets now total approximately \$210 million at market value.

(Whereupon at 5:22 p.m., the subcommittee recessed, to reconvene at 9:30 a.m., Tuesday, November 26, 1974.)

# IMPACT OF CURRENT ECONOMIC CRISIS ON FOUNDATIONS AND RECIPIENTS OF FOUNDATION MONEY

TUESDAY, NOVEMBER 26, 1974

U. S. SENATE,  
SUBCOMMITTEE ON FOUNDATIONS  
OF THE COMMITTEE ON FINANCE,  
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:45 a.m. in room 2221, Dirksen Senate Office Building, Senator Vance Hartke [chairman of the subcommittee] presiding.

Present: Senators Hartke, Gravel, Curtis, and Fannin.

Senator HARTKE. The committee will come to order.

Yesterday, the Subcommittee on Foundations heard testimony from several witnesses about the impact which our current economic crisis is having on the foundation community, and the impact which the decline in foundation assets will have on those who receive foundation grants. We also heard testimony that some of the provisions of the Tax Reform Act of 1969 are worsening the impact of the declining investment value. So, before we begin today, I would like the record to show that my staff received a phone call from the Internal Revenue Service early last evening, informing this subcommittee that two memoranda on the Special Services staff which had not been made public will now be provided for this subcommittee. We will enter those two memoranda, and all information on the subject, into the record, so they will be made available to the public. These documents, and my conversations with the Commissioner during yesterday's hearings, will be made available to both the Joint Committee on Taxation and the Senate Government Operations Committee, for use in their investigation of the Special Services staff.

I remain convinced that full disclosure of all the facts surrounding the existence of this group is best for the Internal Revenue Service and necessary if public confidence in the Service is to be maintained.

(The material referred to follows:)

JULY 17, 1969.

Memorandum for file.

Subject: Activist organizations.

I called Special Agent Patrick D. Putnam of the FBI to ask him their procedures concerning investigations of organizations. He told me that all FBI activities are centralized. However, in any investigation of an organization, the principal FBI field office in the city where the headquarters of the organization is located is assigned the primary responsibility of assembling information from all parts of the country wherever the organization has auxiliary units. Thus, if an organization has headquarters in Chicago and has chapters or locals spread throughout the United States, all FBI offices throughout the country would send information on the organization to the FBI office in Chicago. That office would

then prepare summary reports quarterly or on a six-month basis as necessary and forward the reports to FBI headquarters.

D. O. VIRDIN.

JULY 31, 1969.

Memorandum for file.

Subject: Activist Organizations Committee.

Mr. Meehan called. He was very upset because Mr. Wright had discussed this matter with Mr. Green yesterday. Mr. Meehan said he wondered what was going on and why it was necessary for Mr. Wright to discuss this with Mr. Green.

Mr. Meehan said that the creation of this organization had been discussed with Mr. Bacon; that Mr. Meehan represented Mr. Bacon at the meetings creating this organization; and that the instructions given by Mr. Meehan were those of Mr. Bacon. The reason why Mr. Meehan sat in the meetings is because Mr. Green was absent.

Mr. Meehan's concern is that there may be conflicting instructions; thus, even though Mr. Green is thoroughly familiar with the matter, the original instructions were those of Mr. Bacon. A copy of the minutes of the meeting which he had prepared were forwarded to Mr. Barth in the Commissioner's office, and Mr. Meehan says now they are over at the White House. Thus, he is most distressed that we might be taking some action contrary to our original commitments.

D. O. VIRDIN.

INTERNAL REVENUE SERVICE,  
July 31, 1969.

Re Activist Organizations Committee.

To: Mr. Snyder.

Thank you for listening to my concern about getting this Committee "off the ground". Notwithstanding this morning's call from the third floor, or my earlier discussion with you, Paul is moving in the right direction. You have selected a person who will be a powerful, dedicated, and enthusiastic Chairman. He conducts meetings exceedingly well. He does nothing to upset any person present, and is very diplomatic and knowledgeable as to the conflicting personalities involved. My past meetings with him, and particularly my discussions with him today, have convinced me that, perhaps for the first time, he has a responsibility where he will really be able to use all the training and knowledge he has received. I visualize the day—perhaps three years from now—when Paul and his group will be called to the White House to receive a Special Award from the President for the tremendous job they have done!

DON VIRDIN.



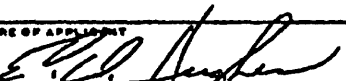
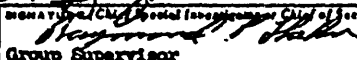
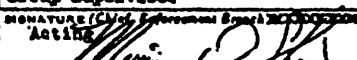
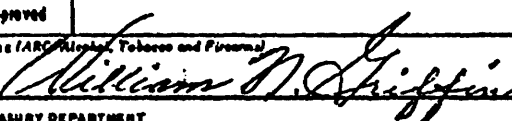
Return  Applicant through Supervisor  
 To: Atlanta, Georgia  
 (Location)

returned to JEFFERSON if approved, and copy should be attached to the travel voucher for the period wherein reimbursement is claimed. One copy will be retained by ARC-ATP.

PART A - APPLICATION		
1. NAME OF APPLICANT <u>E. D. Hughes</u>	2. TITLE <u>Special Investigator</u>	3. POST OF DUTY <u>Atlanta, Georgia</u>
Permission is requested to use my privately-owned vehicle while on official Government business to travel:		
4. FROM <u>Atlanta, Georgia</u>	5. TO <u>Washington, D. C. - June 29, 1969</u>	
6. RETURN TO <u>Atlanta, Georgia</u>	7. ON OR ABOUT <u>July 11, 1969</u>	
8. REASON		

My presence in Washington, D.C. is necessary to assist the National Office with a report on militant organizations, and the financial funding thereof, as it relates to violations of the Internal Revenue Code. The report was requested by and will be submitted to the White House. The trip will necessitate the transportation of a large quantity of material on file which will be used in the preparation of the above report.

This assignment was not anticipated until the date of this request and it coincides with a planned vacation to Washington, D.C. with my family. Upon completion of the assignment in the National Office, annual leave will be taken. Subsistence will not be required after completion of official business until the planned return to Atlanta on July 11, 1969.

SIGNATURE OF APPLICANT 		DATE <u>June 27, 1969</u>
RECOMMEND <input checked="" type="checkbox"/> Approval <input type="checkbox"/> Disapproval	SIGNATURE (Chief, Special Investigations, Chief of Section)  <u>Group Supervisor</u>	DATE <u>June 30, 1969</u>
RECOMMEND <input checked="" type="checkbox"/> Approval <input type="checkbox"/> Disapproval	SIGNATURE (Chief, Enforcement Group)  <u>Acting</u>	DATE <u>June 30, 1969</u>
PART B - AUTHORIZATION (Not valid unless signed below by authorizing official)		
<input checked="" type="checkbox"/> Approved	<input type="checkbox"/> for \$1.18 per mile, in accordance with Section 1763, Subsection 251(2)(e), IRM.	
	<input checked="" type="checkbox"/> for \$1.10 per mile, not to exceed the cost of common carrier, in accordance with Section 1763, Subsection 254(1), IRM.	
<input type="checkbox"/> Disapproved		
SIGNATURE (ARC Manager, Tobacco and Firearms) 		DATE <u>JUL 8 1969</u>
U. S. TREASURY DEPARTMENT INTERNAL REVENUE SERVICE		RC SE FORM ATP - 213 (REV. 1-68)

Senator HARTKE. Our first witness today is Ms. Nancy Hanks, chairman of the National Endowment for the Arts. Good morning, how are you this morning?

Ms. HANKS. I am just fine, and you?

Senator HARTKE. I have sort of a special feeling of empathy with Nancy Hanks, in view of the fact that in Indiana, you know, we have Nancy Hanks, too—the mother of President Lincoln, and the national memorial there. So why do you not come down and grace it with your presence one of these days?

Ms. HANKS. I would like to come very much. I have not been there. I accept your invitation on the spot.

Senator HARTKE. All right, fine.

**STATEMENT OF NANCY HANKS, CHAIRMAN, NATIONAL  
ENDOWMENT FOR THE ARTS**

Ms. HANKS. I was very pleased to have the invitation to testify before this committee, because I think you are providing a great service.

Senator HARTKE. Can you hear back there? I am sorry; this is one of those things. I have complained to the Rules Committee. I cannot find out here—you talk about the chain of command—I cannot find out who is responsible for getting this fixed.

Ms. HANKS. What do I do, shout?

Senator HARTKE. I guess we will have to get some foundation to sponsor a new communications center.

Ms. HANKS. Would it help, sir, if I sat at that end of the table?

Senator HARTKE. No; it will not make any difference. If you go up to the microphone, pull it right up to you. Now they can hear you.

Ms. HANKS. Now they can hear me? It is like shouting testimony, not giving it.

Senator HARTKE. All right, proceed.

Ms. HANKS. A few words in general to begin with. My own long-held belief is that the tradition of private philanthropy in this country is one of the strongest democratic roots that we have in the entire Nation: and I think it should be encouraged in every possible way. While the foundations are certainly not the only, or indeed the largest, form of private philanthropy, they are the most visible and therefore, what happens to them affects the whole range of giving. And therefore, I think, sir, you are not only talking about foundations, you are talking about the whole range of private giving in the country. Our people, since the founding of this Nation, have given not only of money, but very much of their time. This attitude of individuals and groups must be nourished, or it will wither away, and private initiative will vanish in the country, in my judgment.

I will speak briefly today, using the cultural resources of the Nation as an example. As you know, we have artists and cultural institutions as great as any in the world, and if they were counted in this country, as they should be, among our treasures, we would always be the wealthiest country in the world. Yet, our national institutions were, with very few exceptions, built not by your government, but because of the generosity of private sources; and they have been maintained on a continuing basis by individuals and by foundations. Individuals have given of their time, as well as their money, Senator. It is almost incredible. If you look at, say, the museum field in the country, that work force numbers 110,000 people. More than half of that number is volunteer. The philosophies of philanthropy and volunteerism are part and parcel of the same fabric, and one that we must keep.

Now, I will turn to the critical role of foundations in the continuing cultural development of the country. The arts are being hit, in the present economic situation, very, very hard. Sometimes people do not realize that the arts are basically a touring industry. They require energy, they require gasoline, they require staying in hotels, because either they tour to people, or people must come to them. There is almost always a traveling factor; and furthermore, the costs of paper,

lumber, lighting equipment, costumes, have soared. But interestingly enough, in the best soundings that we can take, these problems are being faced by these institutions as a challenge. It is a sense of self-help, and not bailout.

This attitude on the part of the cultural resources of the country, just when they are needed most for the spirit of the country, is because of private initiative, and in particular because of the role of foundations. I want to make, very quickly, six points to give examples as to why the foundations are important in our area.

First of all, they are giving money, they have given money, and they will continue to give money. Second, they have, and were, the first institutions in the country to recognize the arts as public treasures, and not as private treasures. They were the first to say that no person in this country should be denied access to beauty, to creativity, and to a humane environment, for economic or geographic reasons.

The giving of large foundations—Rockefeller, Ford, Mellon, Guggenheim, et cetera—in the arts has spurred other foundations to do likewise, and we hope there will be much more activity in that regard in the future. Dr. John Knowles of the Rockefeller Foundation, who testified here yesterday, has taken a specific role in that regard.

Further, foundations establish mechanisms in one field that are an eventual help to others, for example, as in our own interest in preserving railroad stations. We cannot really save all the railroad stations in the country, but is it not marvelous the Ford Foundation set up the Educational and Cultural Facilities Laboratory some years ago, which is now working on the development of cultural facilities and that the ability of railroads for this purpose has been recognized?

Fourth, the foundations were the first to encourage creativity coming from our neighborhood groups. Some people said: "That is a sociological problem, it is not an artistic problem." Well, it has turned out very much to be both, and the creativity in our country is coming from our roots, and not being imposed from outside, largely because of foundation leadership.

Of course, too, foundations particularly took an early role in giving money to individuals. Our own individual fellowship programs at the Endowment are based on the time-tested methods of Guggenheim and Danforth. This brings me to the sixth point I wish to make, and that is that the Arts Endowment has been able, in 10 years, to get rid of that attitude that you remember, sir, as the fear of Government control in the arts. In my view, we have been successful largely because of foundations. We not only have used foundation principles and procedures for review by professional panels, we not only have worked to encourage other monies, which is an attitude of foundations that we are instilling into the Federal Government philosophy, but we have taken guidance from foundation professionals about funding mechanisms that work, or do not work. Our mandate is to encourage other monies and not to replace them, and for the Federal Government to be a junior partner—important, but junior to private initiative. If our funding mechanisms and policies had been developed differently, we could have failed, and the initiative for the cultural development of the country could in time have shifted to Federal hands from private hands. That would have been a very sad day indeed for this country.

The reason I am here is to say that I want to thank you, and I want to thank the other members of the subcommittee, for all you are doing to strengthen these foundations, and to further the faith of the people in this Nation that private philanthropy, private initiative, is important. That, to me, is the meaning and greatness of these hearings.

Thank you very much.

Senator HARTKE. Thank you, Ms. Hanks.

Let me ask you—have you noticed any decline in the amount of contributions which have come from the foundations, say, in this year?

Ms. HANKS. We will not have an exact reading on that until next year, because that is when the effect will take place. We have had very dire predictions on both the foundation and the corporate situation.

We have received some 20 letters at the Endowment just in recent weeks, requesting a waiving of our matching principles, because foundations pulled out of the grants. It would strike at the very heart of, not only the arts, but the philosophy of the Endowment, if there were many people who could not get the money from other sources, and therefore requested waiver.

Second, we will have better statistics for you, I hope, in January or February, because in working with the private foundations, we are moving right now to set up a quick and fast reporting system from the major cultural institutions of the country, that will give us the figures that we need. We are doing this with foundations.

Senator HARTKE. As regards the matching formula, if the foundations do find it impossible, or not desirable, in their judgment, to operate in this field, how will that affect the Government side of the contribution? Will that mean it will go by default?

Ms. HANKS. The National Council on the Arts discussed this in its meetings just this past weekend, because they are very concerned. After long discussion, they felt that the principle of matching support was so important, in terms of the cultural development of the country, that they would have to hold firm. In other words, the Federal Government would not come in and add to its grant, or waive the matching, except under exceptional circumstances. One, we do not have the money to move in; and second, we feel that there is more private money, there is more money in foundations that should be coming into these fields that we must encourage. Further, we would state that if an organization came in to request that we waive matching, and could not get other money, we would hope that in some ways that we would be able to be helpful to them in that regard. We have just placed someone on our staff to work with corporations and foundations around the country, in an attempt to really be specifically helpful.

Senator HARTKE. How much help have you had in the past, as far as funding and innovative approaches?

Ms. HANKS. Very much. As a matter of fact, all of the innovation, in terms of funding of the arts, has not come from the Federal Government. It has come from foundations or individuals. May I give you two examples very quickly? One is our expansion arts program, which is a Federal program which reaches into the neighborhoods to support professional activity, but largely in very disadvantaged neighborhoods, both rural and urban. We had been told for many years that

the Federal Government just could not get into this field. Well, because of the work of the Rockefeller Foundation, and particularly the Rockefeller Brothers' Fund and some of the other local foundations around the country working with neighborhood groups, we were able to build on this and learn what was needed, and were able to go into a granting position vis-a-vis those groups. That is one.

Senator HARTKE. Has any of this been in what you would call the core city areas?

Ms. HANKS. Yes, most of this is in core city.

Senator HARTKE. What about the geographical distribution of the assistance that you have had in this field, as far as the foundations are concerned, their contributions? In other words, is it—

Ms. HANKS. The money coming into the arts from foundations all over the country; is that your question?

Senator HARTKE. No. The question is very simply whether the money goes primarily into an area of high population, for example, in the Boston-Washington area, Cleveland-Chicago area, San Francisco-Los Angeles area. What about in Boise, Idaho, and maybe in Brownstown, Ind.?

Ms. HANKS. I think perhaps one of the most exciting developments in the last 5 years is the cultural activity in the country. I do not know if you saw the New York Times on November 16 about Birmingham, Ala. But you could pick almost any city in this country, or small town, and this is—

Senator HARTKE. Well, Birmingham is not so small.

Ms. HANKS. I was then going on to Boise and other small towns. This interest in cultural activity is in what is called the "growth stock", and it was referring to Birmingham. The article then went on to talk about all of the small cities throughout the State of Alabama, and throughout the South. This was just one example. The arts have moved from the major cities. They are still very strong there, but they are growing all over this country. It is very exciting, and in great measure it is due, not to Federal support; it is due to private initiative and private funding by the foundations.

Senator HARTKE. Let me just say as a general proposition, I think the foundations would agree that the bulk of the money still goes into relatively small, compacted areas. In other words, Washington, D.C., for example, can get attention, but—let me say, you know, you go to southeastern Missouri, for example, and to Arkansas. Do you know of anything in that area at all that has been used in the field of the arts?

Ms. HANKS. Absolutely. Take the State of Arkansas. We have a program that is called artists-in-schools. It operates in all 50 States, but the State of Arkansas is a specific example. We went into that State with a special program largely because one foundation wanted to come in, and use our treasury fund, to put more artists in their schools. In other words, they needed additional moneys in Arkansas over and above our regular program moneys, and private foundation money came in to do that.

So our programs, which are all on a matching basis, are matched all over this country, in part by private.

Senator HARTKE. Is it not true, though, that most of those areas are probably not going to be in the position to meet the matching require-

ments? In other words, do you come to a situation where you take care of those who have, and neglect those who have not?

Ms. HANKS. We have—

Senator HARTKE. I mean, are the arts only for the rich?

Ms. HANKS. Senator, we have a 20-percent waiver provision in the legislation in order to be particularly helpful in that regard. However, it is not a question of being rich. I mean, we are going heavily into have-not areas. But the ones that need the waiver are relatively few, and this is being handled. As a matter of fact, of course, this is one of the intents of our own legislation; to get the arts into areas of the country where they could not exist for either geographic or economic reasons; and I think we are being very successful, but with private help.

Senator HARTKE. Well, I would hope so. Back in the days of the prior crisis, the depression before this one, the big one, at that time, we had the old WPA, which most people looked upon with a great deal of disdain afterward—but anyone who lived through that era, and who really took a good account of it, will find that the arts were not neglected by the WPA. Now, let me say to you, in Indiana for example, some of the murals on the courthouse walls—now they may not be outstanding bits of art, but they are a demonstration of the talent that was in that community, and you found it all over. There was the Writers Guild, for example, unemployed press people. Now, I do not expect you people in the press table to be unemployed very soon—that is, not before February. But you know, after that, you might be looking for something like the WPA to give you work.

Now, some of the finest people, at the moment, who are writing on the national level under bylines, I can tell you, you will find their names in WPA publications. They were writing at that time for Uncle Sam. Now, I am not suggesting that the Government should underwrite all of it. But I do hope that you would keep yourself constantly alert to the proposition that this country, if it is going to mean anything, that it means it is one people, not just those that can meet matching funds; and maybe sometimes the arts ought to be giving more attention to those needs, where the local community is not capable of making that kind of contribution.

Ms. HANKS. Yes; but sir, first of all, our grants to individuals are all nonmatching, and this is very important. I am sorry that I did not mention that the ones to institutions are matching, because the philosophy of the endowment was to encourage other sources of money to come in. It is not, sir, that the arts are for the rich, but what has been wonderful about Government funding is that in many instances, we have been able to go in with very modest moneys to very poor groups, and just because of our interest, other sources of moneys have come into them. So that is a plus, and it is working.

Senator HARTKE. All right.

Thank you.

Ms. HANKS. Thank you very much.

Senator HARTKE. Thank you.

[The prepared statement of Ms. Hanks follows:]

PREPARED STATEMENT OF NANCY HANKS, CHAIRMAN, NATIONAL ENDOWMENT FOR THE ARTS, CHAIRMAN, NATIONAL COUNCIL ON THE ARTS

Although I cannot speak directly to the point of the impact which current economic conditions are having on foundations, I hope that I can give some idea

of their possible impact on recipients of foundation grants in the arts and, more importantly, reaffirm the very important role of foundations in the support of artists and cultural institutions.

First, I want to say that we do not have enough information on the exact nature of the pattern of support for artists and cultural institutions by foundations, corporations, individuals, governmental units, et cetera. We are making progress. The Ford Foundation has recently released a report on performing arts institutions and the Arts Endowment has completed a survey of museums. In addition to preparing reports on the results of these surveys, the Ford Foundation and the Arts Endowment are working cooperatively to up-date the information.

For Fiscal Year 1971-1972, the latest information available, the total budgets of museums were approximately \$513,000,000, and of that amount, approximately \$22,700,000 came from foundations. When directors of private non-profit museums were asked if they thought foundation support would be of increasing importance in the future, forty-five percent responded in the affirmative, while only three percent felt it would be a diminishing importance.

In another area, Fiscal 1974, the Arts Endowment received a total of \$6,500,000 in donations. Donations from 127 foundations accounted for thirty-three percent of this total.

Because of current economic conditions, we have already received inquiries at the Arts Endowment from grantees asking for a waiver of our customary matching requirement, largely because one or more foundations have had to cut back on anticipated commitments. The Arts Endowment will be unable to provide increased monies to the grantees and therefore these groups must obtain monies from other sources.

I cannot overemphasize the importance of the financial support of foundations to our artists and cultural institutions, however the very thoughtful press release announcing these hearings leads me to address myself to the leadership and initiative that foundations offer and its continuing importance.

I attribute much of the success of the Arts Endowment's programming and avoidance of "bureaucratic government control," which was a concern when the agency was established, to use by the Arts Endowment of policies and procedures developed by foundations. The use of professional advisors in developing policies and recommending on specific applications is basic to our operation. The procedures developed by the Danforth and Guggenheim Foundations for fellowships to individual artists were an important model for the Arts Endowment in setting up its own fellowship procedures. The matching grant concept is another example of a principle of foundation funding that has been adopted by the Arts Endowment.

Foundation leadership has been important in assisting the Arts Endowment in the development of its programs. For example, staffs of several foundations played a leading role in the development of our Expansion Arts program of support to professionally directed community based organizations.

Also, foundations have established many important "action agencies," who not only identify and research a problem, but provide guidance and solutions. An important example is the support of the Ford Foundation for Educational Facilities Laboratories. The experience gained in working with educational facilities has provided an important resource to the Arts Endowment in identifying imaginative ways to improve cultural facility design and utilization. Although the Arts Endowment does not have sufficient funds to assist in capital improvements, except for museum renovation for preservation purposes, over seven hundred inquiries per year are received on this subject. The need is real.

With the experience and expertise of the Educational Facilities Laboratory, and support from the Congress and private sources, an action program has been launched to "recycle," often for use as cultural facilities, many of our finest railroad stations. A conference, film and brochure have served to call attention to the opportunities, the Congress has passed legislation to provide some financial assistance for preserving these important architectural entities, and private initiative at a local level is developing action plans suited to local needs. An even more detailed "how to" booklet will be made available to local groups as a follow-up to the very successful conference held in Indianapolis, Indiana.

In closing, I want to note that a major national foundation has taken the initiative to convene two meetings recently of other foundation and government representatives to discuss what effect changing economic conditions are having on support for artists and cultural institutions and, more importantly, how new and increased sources of support can be identified. I am confident that these efforts will lead to positive action by a group of foundations to develop a heightened awareness of the role of artists and cultural institutions in improving the quality of life for all of our citizens.

Senator HARTKE. All right, the next witness is Dr. Landrum Bolling of the Lilly Endowment. Dr. Bolling is not an unfamiliar figure in the State of Indiana, having served on the other side of that coin at one time, I suppose, as the president of one of the most outstanding schools in the country, Earlham College—which, incidentally, is in Richmond, Ind., and it is the hometown of Mrs. Hartke.

**STATEMENT OF DR. LANDRUM R. BOLLING, EXECUTIVE VICE PRESIDENT, LILLY ENDOWMENT, INC.; ACCOMPANIED BY THOMAS LOFTON**

Dr. BOLLING. Senator, it is a pleasure to participate in the hearings. I brought with me Mr. Tom Lofton our legal counsel, who is here to help answer any technical questions you may have.

I have submitted a written statement, sir, which you have there. I will not burden you to read the whole thing. I would like to summarize some of the main points there and comment perhaps briefly on some of the testimony yesterday.

Senator HARTKE. That would be fine.

Dr. BOLLING. As to the central issue raised by your invitation to participate in these hearings, the effects of the current troubled economic situation upon foundation grantmaking to educational and charitable institutions and their programs, let me give you just a few bare details concerning our experience at Lilly Endowment, and here I will just skip over the second page of my testimony.

In 1973, the Lilly Endowment made distributions of grants and administrative expenses totaling \$32 million plus. Already this year, we made grants of more than \$40 million, and by December 31, our total payments will be in excess of \$53,200,000. Of that amount, over \$3 million represents excess payments above the minimum, a kind of safety margin we have imposed on ourselves to make sure we more than comply with the minimum payout requirements. Another \$800,000 represents the so-called excise tax or auditing fee levied under the Tax Reform Act of 1969. Incidentally, Mr. Chairman, on behalf of Lilly Endowment and speaking, I am sure, for my other colleagues in the foundation field, we are very grateful for the leadership you have taken in urging consideration of the possible reduction of that tax from 4 percent of annual income to 2 percent. We certainly do not object to any reasonable charge for the Federal audit of our accounts. However, as you have wisely pointed out, the excess charges for this auditing service become in reality not a tax against foundations but a tax against a charitable organization, for it reduces by that amount the funds available for charitable purposes.

Over the last 2 years, we have paid out more than \$2 million for this auditing fee. We naturally wish you success in this effort.

As we all must keep in mind, the minimum payout in any given year is fixed on the basis of a percentage of the total assets of the foundation, or the total income, whichever is larger. As the percentage figure has crossed the 5 percent level and may, under the discretionary authority given to the U.S. Department of the Treasury, go higher and higher, almost all foundations will be operating under the percentage of assets formula and then having to seel off capital assets to



meet the grantmaking levels required. As we were told yesterday, the Treasury has already indicated, as they see it now, that for next year, when they fix the figure in about April, they probably will tell us that next year we are going to have to pay out 7 percent or more of assets. They arrive at the formula apparently on the basis of their calculations of what it costs the Federal Government to borrow money.

Now this current cost of Federal borrowing is obviously one of the criteria, but only one of several that they could use, and we hope very much that you and this committee may urge upon the Treasury a reconsideration of that rather simplistic formula for calculating the payout for next year.

Let me give you just a little bit of our experience at Lilly during 1974. Naturally, we try to make our income carry our grants as far as they will, but by the end of June, we had been compelled to dig into capital to the extent of \$12,600,000 in order to cover the grants payable up to that point. By the end of last month, October 31, 1974, we had reached the point where the cumulative reduction in our capital, over the 10-month period, was \$29 million, and by the close of this fiscal year, December 31, we estimate we will have spent all of our income received during this year plus \$35,700,000 taken out of capital in order to meet our grant requirements.

Now, so long as the boom market continued, and our assets grew, we could invade capital assets without serious effect upon our continuing ability to meet the needs of the charitable organizations we undertake to support. But once the economy goes sour and the market goes into a major and prolonged slide, we face real problems for the future, and I think, sir, the big question before us is how to handle this thing so that the foundations can, over the long future, do the job they are expected to do. Much of our thinking when the Tax Reform Act of 1969 was written—and this thinking was reflected by Members of the Congress, by some of the foundation executives, by a lot of people who supposedly knew where our economy was going—was that we were just going to continue up and up in this booming economy.

Well, it did not work out that way, and so now we are seeing a very definite shift in all of this. Again let us look at the Lilly Endowment experience. As of December 30, 1972, our assets stood at \$1,248,251,000. During 1973 they declined by slightly more than \$100 million, a net decrease of 8.46 percent for that year.

Then came the troubled year of 1974. Now interestingly enough, during the first 6 months of 1974 we were doing all right. We made grants of close to \$21 million in the first 6-month period, using over \$9 million from income and over \$12 million from capital.

Despite this invasion of capital, the total net market value of our holdings, as of the end of the first 6-month period, held at a figure of about \$1,142 million or an increase actually of about 1 percent above what it had been in December of the year before.

But then the slide began, and I think the fact that this slide came in such a rapid way during July and August and September shows how volatile our economy is and how rapidly the whole situation can turn around. During the month of July alone, the assets of Lilly Endowment dropped by \$173 million, a decline of 14 percent from the total value at the beginning of the year. At the end of September,

our assets had fallen to \$829 million, a decline of 27 percent from the January 1 value.

Then October saw a substantial recovery in the market value of our assets back up to a total of over \$1 billion, leaving us, as of that date, with a net decline over the months of about 9 percent. Now that of course is a much more favorable record than that of some other foundations that have been reported in the press, but we do not know what is going to happen between now and the end of December. However, we figure pretty conservatively that our net decline for the year will be at least 10 percent, about 8 percent the year before, so in 2 years we have had a decline of between 18 and 20 percent.

Now, when we hear of other foundations which have lost from one-third to one-half of their assets—I know of one fine foundation that has lost more than one-half of its total assets in less than 1 year—we at Lilly must be grateful that our losses have not been greater. However, we can take no satisfaction in the overall situation or the prospects for the future. We know that we cannot go on sustaining net capital losses of 10 percent a year without first of all a reduction in grants to charity and second a steady erosion of assets that must be taken as a very real threat of extinction within the calculable, not-too-distant future.

When the Congress was considering this Tax Reform Act of 1969, as you recall, Senator, there was discussion as to whether it should establish a fixed life term, a kind of a death sentence for foundations, or not, and the Congress decided it would repudiate that death-sentence formula and have a fixed payout. The assumption was that on a reasonable fixed pay-out requirement the foundations would have continued existence. I would submit to you, sir, that on the basis of our experience right now that if the situation continues as it is, we would have in effect a death sentence going into effect much faster than the previous death sentence had required, and yet there you get into imponderables. You cannot tell what the economy is going to do, and it seems to me all of this points up two very important factors that need to be borne in mind.

And that is, how can we cope with this question of fulfilling what the Congress very rightly set as national policy, namely, that the foundations should pay out all of their income and just as much as they possibly can pay out and yet still function effectively. That, I think, is a sound objective. I think it is quite right that the Congress has laid down minimum payout requirements that should be continued, but the real question is, how can the minimum payout requirement be fixed in such a way that the foundations have some continuity, that they can be expected to continue to serve the purposes that they have in mind, and this means also, how can they make their grants on a basis so that the grantee can know how to plan for their future too.

One of the things that is happening to us right now—and I will just tell you what we are having to think about at Lilly—as we see this erosion of our capital assets, as we see our having to invade capital to a greater and greater extent, our board is becoming more and more reluctant to make long-term commitments. They will tend to say, now, well let us make only the grant that we can pay this year. We do not know what our situation is going to be next year.

A lot of our institutions need to plan projects not just for this year. They have a long-term life. They need to be able to plan something for 2 and 3 years, and particularly, Senator, when you have programs which, as I know you are interested in, programs that are going to make a difference, programs that are going to deal with some of our serious problems, programs of innovation and change that are needed. Those people who risk their professional careers, their institutions, their creative powers to come up with new and creative ideas, they need to be able to fund programs over a period of 2 or 3 years, not just be given a hand-out for this year, as when the foundation draws back, but inevitably foundations right now are pulling back. They are reducing the amount of their grants, and they are tending to think in very short-term patterns, and that, I think, is harmful for doing the job that foundations are set up to do.

We need to be able to plan farther ahead, and here is one of the things that could be done if you seriously consider the possibility of revising the Tax Act, that is to have some kind of fixed payout formula that can be generally understood and counted on. We do not now know from year to year what the formula is going to be. The Treasury makes its determination anew every year, and it is never made clear just what its formula is for doing this.

I do not come before you with a specific proposal as to what it should be, whether it is  $4\frac{1}{2}$ , or 5 percent, or 6 percent, or whether you apply a sliding percentage to values as of some freeze-base year. You have several proposals before you now as to what the formula ought to be, but I would submit to you, sir, that it would be a great help to the foundations and a great help to the grant-receiving agencies if they could have something they could count on as a definite formula by which to operate, so I make a special plea for that greater clarification in the formula and a fixing of that formula on a basis that allows a foundation to continue to function and not to just have the steady year-by-year erosion of total assets, as we are now experiencing.

Now, I would like to just say briefly one or two other things as I close. We ought to realize that our economy is not an ever-upward and onward kind of line on a graph. Our economy is changeable; it is volatile; it is subject to pressures from all sorts of sources here and abroad, and therefore it is very difficult, it seems to me, for the foundations to carry on with a payout formula which was created in a period of boom times and great expectations of continued growth. If foundations are going to be able to function over a long period, then they need to be able to function in hard times as well as good times.

Another comment I would make is, there ought to be some consideration given to the possibility of a change in the status of foundations as defined by the law in order to put them on something of the same basis as other charitable organizations. Foundations are not being created at the rate they once were. At the same time, foundations are going out of existence today at a higher rate than ever before in a very long time. In our own home State, Senator Hartke, the Irwin-Sweeney-Miller Foundation is folding up. Whether they are going to go completely out of business or just go into hibernation I don't know—but they are cutting off grant making, their staff is being dispersed, and here is a foundation that has been giving \$3 million a year. They are simply closing down.

Senator HARTKE. Why?

Dr. BOLLING. Well, the reduction in their assets, and there is just a great sense of uncertainty about the future, and there are several others around the country that are doing that. So you have got a number of foundations that are either closing down or going into what I would call hibernation, simply suspending operation.

Take the Clement Stone Foundation. They have stopped their grant-making; they are giving advice to grant recipients, but they have cut off all grant-making.

Senator HARTKE. This is the Clement Stone Foundation?

Dr. BOLLING. The Clement Stone, yes. And the DJB Foundation in Scarsdale, N. Y., is another one that is just now closing down. There are a number of foundations which a few years ago were very active, giving, some of them, as much as \$3, \$4, \$5 million a year, now suddenly shutting down.

I think it is a great pity if this is going to continue to be the trend. One of the things that could help, it seems to me is to change the law in such a way, which you in the Congress will know better how to formulate than I could suggest, to give encouragement to people to maintain foundations and to create new foundations under proper guidance and supervision.

The foundations are definitely being discouraged today by the way the tax laws are written and particularly by the fact that the foundations are regarded as second-class citizens in the philanthropy field. The tendency is toward giving your money to something that is safe: A church, an established college or university. The foundations, if they do their job as they should—and I do not say they always have, Senator, and you know this as well as anyone—but insofar as foundations do their job and fulfill the kind of social progress purposes that you have stressed so much in these hearings, this time and earlier, then they need to be encouraged through the sort of incentives which are not given to them, incentives for creating and giving to foundations similar to those that encourage giving to some of the old-line established churches, schools, colleges, and so on.

For example, let me give you another illustration. I know one foundation—I suppose I should not indicate the name of it now—a major foundation which is giving serious consideration to changing its status to that of a "support organization," which means it will no longer function as a discretionary grant-making body, but will list with the Treasury a select group of colleges, universities, and hospitals to which they will give all of their money. Once they agree to go into that status, they do not have to pay the excess tax, and they are not subject to the mandatory payout requirement.

Now their board is doing that, as I understand, because they do not see how they can cope with this present payout requirement, and that means—I do not mean this invidiously, but in a sense that is a kind of throwing in the towel for a foundation. Foundations ought to be on the cutting edge of social progress and social change in this country. If foundations cannot do that, then why should they exist? If they can't function effectively over the years as grant-makers, then they will be tempted to have the money given outright to established hospitals, colleges, and churches.

But if we are to have foundations do their best work in a time of social ferment, to be the social catalyst that we ought to be, then we have to have the hope that we can continue to function and be treated as first-class philanthropic citizens and not as second-class philanthropic citizens.

Let me just say finally, Senator, you have asked various ones of us several times what is the philosophy that underlies what foundations are doing, and I would just like to make one very simple point on that.

Senator HARTKE. I talked to Dr. Goheen about that last night. We discussed it here, and we discuss it when we get out of here. I am ready to hear a new view.

Dr. BOLLING. I do not know whether this is a new view, but it does seem to me that one basic philosophical imperative for the foundations is this: Our job should be to stimulate and to support voluntarism in the handling of the many public needs and social responsibilities. We are catalysts; we are stimulators; we are challengers trying to help mobilize the various creative voluntary talents of individuals and organizations across the country. Now that is to me the heart of the whole issue. If we do not do that, we are falling down in a serious way in our responsibility.

We of course are involved in sustaining the openness, the pluralism of American life, and you have heard a lot about this, and I think this is important. We are also involved in encouraging innovation and change and experimentation, and again, these are things the foundations can do that often Government cannot do; Government is unwilling to do, or it is inappropriate for Government to do.

But in order to be able to sustain that sort of innovative forward thrust of foundations, they need to be given some sense of assurance that they are accepted as regular first-class citizens in the field of philanthropy and that they have a chance to husband their resources in a responsible way so that they can continue to function.

That, Senator, is really the sum and substance of what I have to suggest to you. I have been here not to say: Adopt this formula, this pattern, this blueprint, but to urge upon you serious efforts to rewrite the crucial passages of the tax law to make possible the continued functioning of the foundations as creative change agents in our society, as they should be.

Senator HARTKE. All right, one thing I would like to say is that we have heard this repetition of the disastrous economic situation, and here we have a case of an initiative by the Government in which the stated policy of Government is, you can expand the American economy by strangling it to death.

Well, let me point out, though, you see, if you are really in the category of being a second-class organization—let us make that assumption for the moment—I think it is only fair that you look at it from a U.S. Senator's viewpoint, especially a person on the Finance Committee.

No. 1, we are dealing with the tax laws, and that is what I am concerned about, and that is what we are dealing with here, and the ultimate end result—let us assume that I would take the position which is being advocated and which is being presented here—do you really think I could go to the floor of the Senate and defend the foundations

at this moment? I would tell you, I would feel very hard-pressed. I am telling you that, and that is why I keep on probing and asking for that next step.

Let me be very specific with you. The mere fact that a foundation is created or goes out of existence in and of itself may have a multitude of reasons for it.

Now that is a fact of life. Now as I have said repeatedly, I am not opposed to subsidies. I mean, I had to stand in the floor of that Senate and defend that Railway Act, as much as I thought they were approaching it wrong, and still go back and tell them it was not a question to me at that time of whether we were going to solve it in a fashion in which I thought it should be solved, but the question very simply was whether you were going to permit the whole thing to go and be liquidated and end up with a total depression for all of the United States.

Now that was a choice, but let me say to you, when you tell me you become second-class citizens to the other type of charitable organizations, maybe the fault is not in the laws which deal with foundations, but maybe the fault is of not going ahead and providing for the same type of tax treatment or some type of modification in the tax treatment for the other charitable organizations. Do you follow me?

Dr. BOLLING. I follow you, sir, yes.

Senator HARTKE. But you see, the evidence I have so far—and I will say this to those that are there, and this is what they have got to think about—that is just as likely a conclusion as the one to say that the law is putting the foundations out of existence, because I could draw equally the distinction that the reason it is not to the advantage of the person who is taking the tax subsidy—and I am not talking about the foundation giving now, but I am talking about the acquisition of the fund itself—is that it is no longer in the best interest of the taxpayer to prevent that subsidy.

When I ask for example—and I say to you I am not being critical of the foundations, because the Internal Revenue cannot get this either—what is involved here; what is the total; what is really happening to all of these 28,000 institutions, and is the cause of the so-called dropping out simply because of the 4 percent audit fee? I mean is the cause the payout?

Is it not true that with the diminution of the assets, frankly, that the payout requirement is on a percentage level and therefore is adjusted in relation to the total asset, is that not true?

Dr. BOLLING. Yes.

Senator HARTKE. If the 6 percent figure, in other words, is fair, maybe it should be reduced to a different level, but I might say, just for the benefit of Dr. Goheen, I want to tell him that I am not going to stand on my quantitative argument of last night, and he would appreciate hearing that.

But the point still remains that there has to be some identification and clarification in this area, and that is what these hearings are all about.

Dr. BOLLING. Sure.

Senator HARTKE. I am struggling to find someone who at least has the initiative in the foundation organization to demonstrate to me exactly the social relevance of foundations. Ultimately, you will get

the death sentence because more and more you are going to find people raising these questions.

Dr. BOLLING. Sure.

Senator HARTKE. And I think these questions ought to have been raised in a time of good times, not in the sense of frustration which occurs in the economic conditions of today.

Now let me go through these figures that you had here. On page 4—and this is where you are into the figures—from December 30, 1972, where you had \$1,248 million to October 1974, you had \$1,039 million. Is that correct?

Dr. BOLLING. Right.

Senator HARTKE. Now how much of that is just attributable to these simple economic declines in the value of the assets? Most of it? I do not want percentages exactly. Or let me say, Dr. Bolling, what I am driving at, I am trying to isolate how much is really due, simply to the decline in the economic condition. How much of this has nothing whatsoever to do with the law. How much of it is due to the 4 percent audit fee?

I have indicated before that if you are going to tax charitable organizations, let us tax them and get it over with. Let us do it honorably and sensibly and not call it by some other name.

So, I would say to all of you, as far as I am concerned, that the audit fee should be. Let us just stop the, you know, Mickey Mouse business. That is why I am—in favor of reducing the excise tax.

But what I am trying to determine now in the total of that decline, how much of it is simply due to the decline in the economic situation generally.—Do you know?

Dr. BOLLING. I would say roughly \$100 million.

Senator HARTKE. \$100 million? Well, then the rest of it is due to the requirement of the—

Dr. BOLLING. Payout.

Senator HARTKE [continuing]. The payout, then is that right?

Dr. BOLLING. Yes.

Senator HARTKE. All right, now assuming that that is so, and you have indicated that sooner or later one or two things happen: you either have to drastically reduce the payout or ultimately you get that death sentence by attrition. Is that correct?

Dr. BOLLING. Right.

Senator HARTKE. Let me ask you then—maybe you have answered this, but I will ask you again—by what standard do you have a right to claim perpetuity as distinguished from the utilization of these funds now in the economic sector, in the social sector? In other words, the subsidy that is involved, which we do not even know how much is involved. The Internal Revenue Service does not know how much is in there.

Dr. BOLLING. Well, let me give you just a bit of an answer on that. If you would assume, for example, that all of the capital that was invested originally in creating the Lilly Endowment was the right of the Government to claim, the total amount, the \$100 million. So the Government gave up the possibility of collecting \$100 million.

Actually, they would not have collected \$100 million, but that was the total amount that was put in to creating the endowment over the year that has grown to over \$1 billion, and in the meantime, it has

given away several times the total amount of the original capital, and the same thing has happened to Ford, and it has happened to various others, so that the Government in foregoing the tax that it might have otherwise collected has nonetheless set aside a fund of money which has been managed and has grown and has performed public services, public functions over the years, far beyond what that money would have provided if it had been taken by the Government originally.

So it seems to me that is another part of the consideration that needs to be borne in mind.

Senator HARTKE. Let me ask you, do you honestly believe, and this is your contention, that if foundations should cease to exist, there is no one, no organization that could take its place?

Dr. BOLLING. What do you mean?

Senator HARTKE. Let me point out the seriousness of this charge, even by your own statement, and I think this is a fair appraisal of what happened here.

I am on page 5, reading from your statement.

When the Congress was considering issues related to foundations prior to the enactment of the Tax Reform Act of 1969, there was considerable discussion of the possibility of setting a 25-year fixed term remaining life for foundations.

So in other words, I am not posing this as a threat, I am not posing this as my conclusion. I am posing this as a factual question of just saying, if the foundations cease to exist, is it the contention that nothing would come, or no organization or no one would take its place?

Dr. BOLLING. Well, no. The Government obviously has to step in and do the things that the foundation has been doing.

Senator HARTKE. Do you think the Government would step in?

Dr. BOLLING. In some cases, yes, no doubt, but in other cases, probably not.

You know, the social needs are going to be met, one way or the other, probably, but it means that the greater pressure will be upon the Government to provide those services and it seems to me the things that you have said over and over again, Senator, that we need alternatives to the Government, is a very sound principle, and the foundations, it seems to me, if they are properly managed and properly supervised, are a beneficent alternative to Government in performing many public services. The main job of the foundation executives and of the Government that supervises is to see that they fulfill that public responsibility.

And that is why it seems to me, Senator, you are very much on target when you keep probing and probing. What you are doing in these hearings is really significant, and I would like to say just a word about that, if you do not mind. We will justify ourselves not on the basis of whether we are "doing good," you know; just "doing good" in the world is not ample justification for our existence. But I think if you want to look carefully at some of the crucial problems that we face in our land and how are we getting at them, then we see we need a number of different ways of getting at those problems.

Let me give you two or three illustrations. One of the great problems we face in this country right now is the bringing up of little children in the face of family disintegration with little children being abused, neglected and abandoned. We made a grant recently to the department of psychiatry out at the University of Colorado, which



is studying the problem of child abuse. The highest, the largest single cause of death of children under 3 years of age is being beaten to death by their parents or other adults who have them in their care. It is an incredible thing. More serious than any single disease is child abuse.

Well, we decided this is something we wanted to help do something about. We wanted to see what could be done with helping to improve the possibility of a good life for little children. We are supporting some family training programs, some early childhood care programs. The foundations are beginning to discover this pre-school problem.

Now, the public schools have been in existence for a long time. The public schools are beginning to talk about what needs doing below kindergarten. I do not know whether the public schools ought to go into that field or not, but here is a great crucial area that has to do with juvenile delinquency, has to do with child abuse, has to do with various social problems.

Now, some of the foundations—Lilly is just one—are beginning to take an interest in that whole question of family disintegration and of early childhood care, training and development. A lot of the most important problems originate in those first 5 years of life, and we have been so slow in working up to that. Well, the foundations are getting into that field. Now, if we do that job properly, we will have done something for the whole country that the Government, State, local and Federal in all these years did not get at, and that to me will be a major social contribution that we will have made if we are able to help in some significant way in that field.

And I could go on to some others.

Senator HARTKE. All right.

It is your contention that the justification then is not merely on the fact that the amount of money which it would take if the Government followed the same program, assuming it would, not merely the fact that it would cost more money if the Government did it, but simply because of the fact that it is an area in which, for one reason or another, the Government either has not or will not go ahead and move.

Dr. BOLLING. Yes, sir, that is exactly the kind of case Dr. Knowles yesterday was telling you about, Rockefeller's work in the development of new types of wheat and so on. Now, the U.S. Government has been in agriculture for 100 years in all kinds of ways, but it was a private foundation that really got us going in developing new breeds of wheat and rice, and did a tremendous lot toward trying to cope with the hunger problem. It is not that we foundations have the resources or ever will have the resources to supplant the Government in any field, but it may be that being able to move faster, and looking out on the growing edge, we can see some of the problems that ought to be dealt with before the Government gets moving toward dealing with those problems. It seems to me that is one of the major justifications for our existence.

Senator HARTKE. Now, let me ask you, do you think Lilly is going to cut back this year on grants?

Dr. BOLLING. No, sir, we will not cut back this year. We will have the highest level of grant payments this year we have ever had, and

of course, in one sense, we have no choice in that we are locked into a formula under the Tax Reform Act of 1969. We will fulfill our full requirements, plus a safety margin of maybe \$3 million just to make sure we do overspend the minimum that is required of us. For 1975 we will make grants of about the same level because again, the amount that we will be required to make will be based upon the formula which takes into account our holdings for this year.

So we will not make any, as far as I can tell, any significant decline in our payout in 1975. But 1976 may be a very different situation because of the formula, and the think which my board is now increasingly unwilling to do is to make commitments beyond 1 year because they say, we do not know what is going to happen. We will have to invade capital, but we don't know by how much. If we make commitments, we are going to fulfill those commitments, But we don't want to be in a very embarrassing situation. So we are feeling very reluctant to make any long-term grant commitments.

Senator HARTKE. Senator Gravel?

Senator GRAVEL. Thank you. I just wanted to compliment the witness.

I have become aware of some of the activities of your foundation, and I became aware of the process of decisionmaking involved, and I would say I was very, very impressed with the approach taken. I do want to say to the chairman also that I think the cross fertilization offered by the voluntary sector of our economy through the foundations that takes place with the wealth that we have certainly embellishes our total creativity as a nation. I hope that this Committee in its deliberations, and certainly the Senate, will retain what is I think a very vital sector. Otherwise we can always take it and turn it over to the Government. But I think here we would suffer a great deal as a society.

So I want to compliment your foundation for the efforts you have made, and I would also mention your statement—you have a very fine statement.

Dr. BOLLING. Thank you, Senator Gravel.

Senator HARTKE. Thank you.

Dr. BOLLING. Thank you very much, Senator.

[The prepared statement of Dr. Bolling follows:]

PREPARED TESTIMONY OF LANDRUM R. BOLLING, EXECUTIVE VICE PRESIDENT,  
LILLY ENDOWMENT, INC.

Mr. Chairman, as Executive Vice President of Lilly Endowment, Inc., of Indianapolis, I am pleased to respond to the opportunity given to us to present testimony on certain aspects of the current and future problems of foundations and of the charitable and educational services they support.

The problems of the economy over the past year, including the drastic erosion in stock market values, have created serious problems for a great many of the educational, social welfare, cultural and charitable agencies that depend upon private philanthropic giving. If individuals do not feel they have surplus funds, most of them won't give any away. If business concerns don't make profits, they are unlikely to make their legally allowed tax deductible contributions to charity. If foundations suffer drastic losses in their capital holdings, they must sooner or later reduce drastically their grants payout and they may and can be forced out of existence entirely.

I take it, Mr. Chairman, that the purpose of these hearings, however, is not so much to publicize the problems of donors—individuals, corporations and foundations—real though they are, as to focus attention on the continuing and

growing needs of educational, social service, and charitable institutions and the issue of meeting their needs in a time of economic distress. Their programs and very survival will be inevitably threatened by a decline in philanthropic giving. If a major source of such funding, the private foundations, should dry up, many charitable and educational services will face disaster, with resulting new burdens on the taxpayer.

One of the major peculiarities of American society—and, we have generally believed, one of its great strengths—has been its capacity for stimulating, organizing and drawing upon volunteer energies and private resources to deal with many of our community problems. Our free, open, pluralistic society is closely linked with the maintenance of a strong network of local, regional and national private organizations supported by private funds. In the total complex of private philanthropy the foundations are an important factor. Today the functioning of foundations is a matter for public concern, their capabilities for fulfilling their public service functions are being curtailed, and their long-term survival (for some, even short-term survival) are in question.

In these hearings, as I understand it, you are attempting to get at, first of all, the facts concerning the impact of the stock market decline upon foundation giving. Let me give you, very briefly, our story at Lilly Endowment. As we all know, the Tax Reform Act of 1969 sets certain minimum payout requirements; we, in common with other foundations, intend to meet those payout requirements.

In 1972 Lilly Endowment made "qualifying distributions"—as the law describes grants and administrative expenses—totaling \$32,305,892. Already this year, we have made grants of more than \$40,000,000 and by December 31, 1974, our total of qualifying distributions will be somewhat in excess of \$53,200,000. Of that amount over \$3 million represents excess payments above the minimum, a kind of "safety margin" we have imposed on ourselves to make sure we more than comply with the minimum payout requirements. Another \$800,000 represents the so-called "excise tax" or auditing fee levied under the Tax Reform Act of 1969.

(Incidentally, Mr. Chairman, may I express, on behalf of Lilly Endowment and my other colleagues in the foundation field, our deep appreciation for your leadership in trying to get the Congress to reduce that tax from four percent of annual income to two percent of income. We certainly cannot object to any reasonable charge for the federal audit of our accounts. However, as you have wisely pointed out the excess charges for this auditing service become, in reality, a tax against the charitable organizations for it reduces by that amount the funds available for charitable purposes. We naturally wish for the success of your good efforts on this matter.)

As we all must keep in mind, the minimum payout in any given year is fixed on the basis of a percentage of the total assets of the foundation—or the total income, whichever is larger. As that percentage figure has crossed the five percent level and may, under the discretionary authority given to the United States Department of the Treasury, go higher and higher, almost all foundations will be operating under the percentage of assets formula and thus having to sell off capital assets to meet the grant-making levels required. Let me give you our experience at Lilly Endowment during 1974. Naturally, we make our income go as far as it can, but by the end of June we had been compelled to dig into capital to the extent of \$12,658,000 in order to cover the grants payable up to that point. By the end of last month, October 31, 1974, we had reached the point where the cumulative reduction in our capital, over the ten-month period, was \$29,101,000. By the close of our fiscal year, December 31, we estimate we will have spent all of our income received during the year, plus \$35,700,000 taken out of capital.

Now, so long as the boom market continued, and our assets grew, we could invade capital assets without serious effect upon our continuing ability to meet the needs of the charitable organizations we undertake to support. But once the economy goes sour and the market goes into a major and prolonged slide, we face real problems for the future.

Let me illustrate from the Lilly Endowment experience over the past two years. On December 30, 1972, Lilly Endowment assets stood at \$1,248,251,232. During 1973 they declined by slightly more than \$100,000,000, a net increase of 8.46 percent. Then came the troubled year of 1974. During the first six months of 1974 we were doing all right. We made grants of close to \$21,000,000, using over \$9,000,000 in income and over \$12,000,000 from our capital. Despite this invasion of capital, the total net market value of our holdings rose from \$1,142,605,000 (as of December 31, 1973) to \$1,155,405,000 on June 30, 1974, or an increase of 1.12 percent. But then the slide began. During the month of July alone our assets dropped by about \$178,000,000, a decline of 14.03 percent from the

total value of our assets at the beginning of the year. At the end of September our assets had fallen to \$529,422,000, a decline of 27.41 percent from the January 1 value. October saw a substantial recovery in the market value of our assets—back up to a total of \$1,039,696,000, leaving us, as of that date, with a decline over the ten months of 9.01 percent. What the record will show at the end of this troubled year, nobody can foretell. We must calculate, however, that the percentage decline for the year, almost surely, will be ten percent or more. If that proves reasonably correct, we must thus acknowledge a net decline of 18 percent to 20 percent for the two years 1973 and 1974.

When we hear of other foundations which have lost from one-third to one-half of their assets in a little over a year, we must of course be grateful that our losses have not been greater. However, we can take no satisfaction in the overall situation nor in the prospects for the future. We cannot go on sustaining net capital losses of ten percent a year without, first of all, a reduction of grants to charity and, secondly, a steady erosion of assets that must be taken as a very real threat of extinction within the calculable, not to distant future.

When the Congress was considering issues related to foundations prior to enactment of the Tax Reform Act of 1969, there was considerable discussion of the possibility of setting a 25-year, fixed term remaining life for foundations. This so-called "death sentence" was, in the end, rejected by the Congress in favor of a mandatory minimum payout to be required of the foundations. The reasoning behind that thinking was that foundations are basically worthy institutions and have important and socially worthwhile functions to perform over time. It was assumed they would continue to function into the long future.

The formula by which the minimum payout was to be calculated was devised, however, in a time of bullish optimism. The assumption was that a kind of "total return" concept, linked to continually upward movement in market values, would justify an upward floating percentage of required payout to six percent and beyond. Our experiences of the past year have shown us how dangerous such thinking is, so far as the long-term capacity of foundations to provide continuing support for charitable organizations is concerned.

The Peterson Commission report, the testimony of some foundation representatives, and the calculations of some tax lawyers and economists have turned out to be unrealistic in the cold light of experience with a sick economy and a faltering stock market. Today there is a remarkable degree of unity of thinking among foundation officers and many of the administrators of charitable organizations that some changes must be made in the tax laws if there is to be long-term future for foundation support of educational, cultural, religious and human welfare organizations. As surely as we are sitting here, if the present trends set in motion by the Tax Reform Act of 1969 continue, most of the American grant-making foundations are going to be forced out of business.

For some this would be a matter of several years. For others it is an immediate reality. Let me just list a few foundations that during this year have either gone out of business or gone into hibernation or virtually suspended all grants. There may be others, but here are ones I know about:

The W. Clement and Jessie V. Stone Foundation, that once made grants of more than \$5,000,000 per year, now provides only advisory services to charitable organizations, and almost no grants.

Trinity Parish, a philanthropic arm of the Trinity Episcopal Church with its own endowment that once enabled it to make grants of several hundreds of thousands of dollars per year.

The Irwin-Sweeney-Miller Foundation of Columbus, Indiana, which for a number of years averaged about \$3,000,000 in annual grants.

There are some other foundations I have heard of but on which I don't have the detailed information but which have announced their dissolution or their indefinite withdrawal from grant-making activities.

To this discouraging news should be added the fact that the formation of new foundations has been drastically slowed and many lawyers will today tell their clients who are considering setting up foundations that it is "not worth the hassle."

I would like to close with just a few overview observations on foundations, private philanthropy and the future of our free, pluralistic society. First some basic principles:

One, governments cannot and should not attempt to finance and manage all of our educational, cultural and charitable services.

Two, the private financing and private managing of a wide variety of these services is desirable in maintaining the rich diversity of American life—for in many cases these private organizations are more creative and more efficient than comparable services provided by government agencies. Moreover, some of these services should not be or would not be attempted by government.

Three, sustained encouragement should be given to private individuals and corporations to set aside private funds voluntarily for the public good.

Four, foundations, subject to strict standards of accountability, should be viewed as permanently valuable components in the broad network of private philanthropy and should be allowed to function on equal terms with other non-profit educational, cultural and charitable organizations. With abuses of a few foundations in the past corrected, foundations should be viewed as worthy partners with government in providing certain essential public services, not as suspicious characters to be hounded out of business.

And now as to specific recommendations:

1. A reduction of the "excise tax" from four percent to two percent and its clear definition as an auditing and governmental supervisory fee. To go down the road of taxing non-profit, charitable organizations is to invite a drastic upheaval in our whole social life, with consequences for schools, hospitals, churches, and welfare organizations that are frightening to imagine.

2. A major revision in the formula for calculating the minimal payout requirement to the end that foundations and the charities they support can have some reasonable bases for continued operations. There are several options worth considering but serious and immediate attention should be given to a practical arrangement that does not impose, as is presently the case, a steady year-by-year erosion of capital assets.

In the whole broad field of philanthropy we are dealing with a great many long-term needs and problems. We should not be playing short term, sunny season games with those needs and those problems. National policy should reflect a national will to stick with those crucial problems and essential services over the long haul, through good times and bad. I urge upon this Committee that you give serious and immediate attention to the defining of new policies and the revision of appropriate legislation to make it more nearly possible for foundations to do their work in behalf of charity effectively and for as long as they are needed.

Senator HARTKE. All right, our next witness will be Robert Bonine from the Minnesota Council on Foundations.

You may proceed.

#### **STATEMENT OF ROBERT BONINE, EXECUTIVE SECRETARY, MINNESOTA COUNCIL ON FOUNDATIONS**

Mr. BONINE. Good morning, Mr. Chairman, I have submitted my full statement to the committee. Yesterday you indicated that you have heard a lot of testimony from the eastern seaboard. You were curious to see what was happening in the heartland and in the heart of the heartland. I have some information.

I might also add that even though 12-digit computers are difficult for the IRS to handle, in Minnesota we do not have that problem. My information covers the period of December 31 to October 31, 1974.

There are an estimated 450 private grant-making foundations in Minnesota whose current assets total around \$450 million. It is further estimated that these foundations annually distribute \$22 million in charitable contributions.

I have made a sample of Minnesota foundations to provide a sense of the impact of current economy on those foundations. We have studied extensively some 22 foundations. The size of the sample ranged from \$114 million to \$274,000, and include the Bush Foundation and the Hill Family Foundation of Saint Paul, which are among two of the Nation's largest 50 foundations.

The foundations in the sample represent an estimated 85 percent of the aggregate asset value of Minnesota's private grant-making foundations, even though the 22 foundations represent only about 5 percent of Minnesota's 450 foundation.

As a result of our study, it can be demonstrated that Minnesota foundations have experienced a substantial decline in the market value of their assets, although the collective asset decline is less than the decline of the Dow Jones Industrial average of the same period. There is evidence that the adjusted net income of the Minnesota foundations has increased in the face of a general market decline, at least for the short term. During the next 12 months or so, Minnesota foundations as a group expect to make distributions almost equal to the preceding year. However, a significant number of Minnesota foundations will distribute fewer dollars in the current fiscal year because of sharp market declines.

Moreover, by provision of the Tax Reform Act of 1969, Minnesota foundations will be obligated to distribute amounts in excess of income received. In almost every instance, those foundations studied find income failing to match the amount required for distributions. It is therefore reasonable to assume that foundations will consider modifying their investment strategies to seek more income. Many foundations may reduce their equity holdings and make greater use of fixed income securities in order to obtain income sufficient to meet the current payout requirement of 5.5 percent and next year's payout requirement of 6 percent or more.

Under current conditions, Minnesota foundations and most others appear to be undergoing a long-term erosion of their purchasing power, and much testimony has been given on that, and I will not go further on the erosion aspect.

As a whole, Minnesota foundations estimate that they will distribute slightly fewer dollars in their current fiscal year than in the past fiscal year. Because the required payout increased from 4 $\frac{3}{8}$  percent to 5 $\frac{1}{2}$  percent for most Minnesota foundations, a significant increase in the distributable amount should also have been found. That is not, however, the case. It is believed that in the past fiscal year some Minnesota foundations distributed amounts greater than the required 4 $\frac{3}{8}$  percent. In the current fiscal year, foundations are obligated to distribute 5 $\frac{1}{2}$  percent of net income, whichever is greater. In most instances, however, income is proving to be less than 5 $\frac{1}{2}$  percent. In short, the minimum required payout will become the maximum payout.

Minnesota foundations pay approximately \$1 million annually in Federal excise taxes. At a time when the amounts foundations will be able to distribute to grantees will decline, the presence of the excise tax looms large. If, for example, the excise tax were 2 percent instead of 4 percent, Minnesota foundations could distribute almost \$500,000 more to donees.

Under provisions of the 1969 Tax Reform Act, Minnesota foundations will be obligated to distribute an amount equal to 6 percent of the market value of their assets in 1975 and in future years, unless the Treasury letter affects that.

This requirement will have the immediate effect of providing more available funds for donees than would be the case were foundations only obligated to distribute income produced by their holdings.

Unfortunately, the shortfall between income received and payout required will also erode the foundations' principal funds. This, coupled with a sharp decline in the purchasing power of those funds, will erode sharply in the near future the capacity of foundations to meet public needs. For example, a foundation with assets of \$100 million, which earns 10 percent a year on its assets, pay outs 6 percent and suffers a 10-percent decline in its purchasing power, would have only \$50 million in constant dollars after 11 to 12 years.

The prospect of self-liquidation for the foundations now in existence is a distributing prospect. It is even more difficult to accept when there is evidence that fewer new foundations are being formed, and that many existing foundations are terminating. Thus, donees and future donees are faced with the prospect of a dwindling pool of private funds for their support.

Thank you.

Senator HARTKE. Let me ask you, you say that there is a 19-percent decline in asset value, is that right, in your survey?

Mr. BONINE. Yes, sir.

Senator HARTKE. Mr. Bolling just testified that in a 10-month decline, they had a decline of roughly 9 percent.

Is that an indication that Lilly is making a better investment than the 22 in your sample?

Mr. BONINE. Well, sir, it would appear to be that way.

Senator HARTKE. You have also indicated in your statement that there is a probability that many Minnesota foundations will modify their investment strategies to seek more income.

Does that type of modification have any risk for the foundations or for the programs that they support?

Mr. BONINE. It would if in doing so the foundations chose to decrease their dependence on appreciated securities. Foundations would be forced to depend more heavily on fixed income securities, therefore negating the prospect of growth in their portfolios. This would adversely affect the total payout return concept.

Senator HARTKE. Do you know how many new foundations have been created since the Act of 1969, and how many have gone out of existence in Minnesota?

Mr. BONINE. No, sir, I do not know. The information on the birth rates is not known to me; as far as the death rates, if you will, part of that is a subjective measure that I can give you inasmuch as I follow the Minnesota foundation scene quite closely. There has been a termination of Minnesota foundations of some number. That number is known to me through the list of terminating foundations provided by IRS. I cannot give you the exact figures, but I do know that there is a number of those that are terminating. Most of those foundations, however, were very, very small foundations.

Senator HARTKE. Well, the small foundations, do you know why they are going out of business?

Mr. BONINE. I have a subjective view of that, sir, yes.

Senator HARTKE. Why?

Mr. BONINE. I believe that a number of the small foundations have elected to terminate their status inasmuch as they found it uncomfortable to follow the prudent management and administrative practices dictated, mandated by the Tax Reform Act of 1969.

Senator HARTKE. Did they find it financially less desirable to continue in a foundation status? Was that the cause?

Mr. BONINE. In some instances, yes, sir. For example, I remember looking at the 990 of one foundation with assets of minus I think it was \$13. I do not know how they got a negative balance of \$13, but you can imagine that this foundation certainly was in no posture to provide sound administrative and financial, sound administrative management of this particular foundation, and consequently that foundation went out of business.

Unfortunately, one would say, well, there is the death of another foundation. I did not think that was really an unwelcome demise.

Senator HARTKE. Senator Gravel?

Senator GRAVEL. I have no question. It was a very fine statement.

Senator HARTKE. All right, thank you.

[The prepared statement of Mr. Bonine follows:]

PREPARED STATEMENT OF ROBERT W. BONINE, EXECUTIVE SECRETARY,  
MINNESOTA COUNCIL ON FOUNDATIONS

THE EFFECTS OF THE ECONOMY ON MINNESOTA FOUNDATIONS

PRINCIPAL POINTS

1. Minnesota foundations have experienced a sharp decline in the market value of their assets.

2. A study of one group of Minnesota foundations showed a substantial increase in income. However, the increase is insufficient to match the amount required for distribution.

3. It is believed that Minnesota foundations as a group will make distributions almost equal to those for the preceding year. However, a significant number will distribute fewer dollars.

4. Minnesota foundations appear to be faced with a long-term erosion of their principal funds and subsequent erosion of their capacity to meet the future needs of the citizens we serve.

5. The prospect of self-liquidation is disturbing when evidence exists that fewer foundations are being created and existing foundations are terminating.

6. Minnesota foundations will pay an estimated \$1,000,000 in federal excise taxes in 1974.

*A. Introduction*

There are an estimated 450 private grant-making foundations in Minnesota whose current assets total about \$450 million dollars. It is further estimated that these foundations annually distribute \$22 million dollars in charitable contributions.

In 1970, The Minnesota Council on Foundations was formed to encourage creation of a climate conducive to maintaining the vigor of private foundations and philanthropy in the state. To fulfill this purpose, this informal association plans activities to help inform Minnesota foundations of sound administrative and management practices, and to inform interested citizens of the financial and programmatic activities of the Minnesota Foundation community.

*B. The sample*

To provide a sense of the impact of the current economy on Minnesota foundations, the Minnesota Council on Foundations studied 22 Minnesota foundations for which accurate and valid information is available. The sample includes 22 foundations whose market value assets as of October 31, 1974 ranged in size from \$114 million to \$274,000. The sample includes the Bush Foundation and Hill Family Foundation of Saint Paul, two among the nation's largest 50 foundations.

Foundations in the sample represent an estimated 85% of the aggregate asset value of Minnesota's private grant-making foundations even though the 22 foundations represent only about 5% of Minnesota's 450 foundations.



The following private grant-making foundations were included in the sample, which excluded operating and community foundations: The Bush, Hill, Bigelow, I. A. O'Shaughnessy, McKnight, Jerome, Carolyn, Ordean, Davis, Weyerhaeuser, R. C. Lily, Hull, Butler, O'Brien, Ingram, Phipps, Duke, Warren, and Driscoll Foundations, together with the Ober Charitable Trust and the Dell Charitable Trust II.

### *C. The findings*

(1) The aggregate market value of the sampled foundations was \$401,455,000 as of December 31, 1973.

(2) On October 31, 1974 that market value had fallen to \$324,244,000—a decrease of 19.3%.

(3) During that period (December 31, 1973, to October 31, 1974) the Dow-Jones industrial average decreased 21.8%.

(4) Twenty-one of the 22 foundations experienced a decline in the market value of their assets, with decreases ranging from 3.3% to 42.9%. The median decline was 21.3%.

(5) The total average monthly market value for the 12 months of the current fiscal year of the sampled foundations was \$347,050,000 as of October 31, 1974.

(6) Estimated income of the foundations for the current fiscal year is \$15,766,000, which represents 4.5% of the average market value; 4.9% of the October 31, 1974 market value; and 3.9% of the December 31, 1973 market value.

(7) The sampled foundations estimated that they will be obligated to distribute \$17,394,000 in charitable contributions. This is approximately 10.3% more than the income to be received during this period.

(8) In a further study of fourteen (14) foundations, a comparison of the adjusted net income for the current fiscal year with adjusted net income received in the past fiscal year shows that:

(a) 12 of the 14 showed an increase in adjusted net income; two showed no change.

(b) the average aggregate increase in income was 9.0%, with increases ranging from 1.2% to 30.6%.

In comparison of the distributable amount obligated for the current fiscal year compared with the past fiscal year, the same 14 foundations will be obligated to distribute slightly fewer dollars in the current fiscal year, \$15,496,000, than in the past fiscal year, \$15,511,000. Six of the 14 foundations will distribute fewer dollars in the current fiscal year than the past fiscal year.

(9) In 1973 the sampled foundations paid \$692,313 in excise taxes; in 1974 estimated excise taxes will be \$806,755. (It is estimated that all Minnesota foundations will pay almost \$1 million dollars in excise taxes in 1974).

(10) A second study of the samples' five largest foundations (which represent 85% of the combined market value of the 22-foundation sample and an estimated 60-65% of the asset value of the Minnesota Foundations) reveals that:

(a) The market value of the 5 foundations decreased 19.4%, from \$332,441,000 to \$268,197,000.

(b) The income of 5 foundations was \$13,084,000. The estimated amount scheduled for distribution is \$14,118,000.

(c) The five foundations will therefore be obligated to distribute approximately 7.9% more than their income during their current fiscal year.

### *D. Comment*

(1) Minnesota Foundations have experienced a substantial decline in the market value of their assets although the collective asset decline is less than the decline in the Dow-Jones industrial average for the same period.

(2) There is evidence that the adjusted net income of Minnesota Foundations has increased in the face of the general market decline at least for the short term. During the next 12 months or so, Minnesota foundations as a group expect to make distributions almost equal to the preceding year. However, a significant number of Minnesota foundations will distribute fewer dollars in the current fiscal year because of sharp market declines.

(3) However, by provision of the Tax Reform Act of 1969, Minnesota foundations will be obligated to distribute amounts in excess of income received. In almost every instance, those foundations studied find income falling to match the amount required for distributions. It is therefore reasonable to assume that foundations will consider modifying their investment strategies to seek more income. Many foundations may reduce their equity holdings and make greater use

of fixed income securities in order to obtain income sufficient to meet the current pay out requirement of 5.5% and next year's pay out requirement of 6.0%.

(4) Under current conditions, Minnesota foundations and most others appear to be undergoing a long-term erosion of their purchasing power, and thus an erosion of their capacity to meet public needs. At the inflation rate of the past two years, Minnesota foundations should grow in asset value at the rate of 10% or more merely to maintain their purchasing power. When also faced with a 6% pay out requirement, Minnesota foundations would have to receive a total investment return of at least 16% per annum to avoid principal erosion. This erosion is virtually unavoidable since it is probably unreasonable to expect that, without taking on high speculative risks, foundation investors can generally expect a long-term total return on invested assets while it is in excess of 9-10%. This kind of arithmetic produces an anticipated annual erosion of purchasing power of about 7% (16% pay out or loss due to inflation vs. 9% total return).

(5) As a whole, Minnesota foundations estimate that they will distribute slightly fewer dollars in their current fiscal year than in the past fiscal year. Because the required pay out increased from 4% to 5½% for most foundations, a significant increase in the distributable amount should also have been found. That is not, however, the case. It is believed that in the past fiscal year some foundations distributed amounts greater than the required 4%. In the current fiscal year, foundations are obligated to distribute 5½%, or net income, whichever is greater. In most instances, however, income is proving to be less than 5½%. In short, the minimum required pay out will become the maximum pay out.

(6) Minnesota foundations pay approximately \$1,000,000 annually in Federal excise taxes. (Those 22 sampled will pay over \$800,000 in 1974). At a time when the amounts foundations will be able to distribute to grantees will decline, the presence of the excise tax looms large. If, for example, the excise tax were 2% instead of 4%, Minnesota foundations could distribute almost \$500,000 more to donees.

### E. The future

Under provisions of the 1969 Tax Reform Act, Minnesota foundations will be obligated to distribute an amount equal to 6% of the market value of their assets in 1975 and in future years.

This requirement will have the immediate effect of providing more available funds for donees than would be the case were foundations only obligated to distribute income produced by their holdings.

Unfortunately, the shortfall between income received and pay out required will also erode the foundations' principal funds. This, coupled with a sharp decline in the purchasing power of those funds, will erode sharply in the near future the capacity of foundations to meet public needs. For example, a foundation with assets of \$100,000,000, which earns 10% a year on its assets, pays out 6% and suffers a 10% decline in its purchasing power, would have only \$50,000,000 constant dollars after 11 to 12 years.

The prospect of self-liquidation for the foundations now in existence is a disturbing prospect. It is even more difficult to accept when there is evidence that fewer new foundations are being formed and that many existing foundations are terminating. Thus, donees and future donees are faced with the prospect of a dwindling pool of private funds for their support.

A STUDY OF SELECTED MINNESOTA FOUNDATIONS  
TABLE I.—COMPARATIVE AGGREGATE MARKET VALUE

	Market value of assets (as of Dec. 31, 1973)	Current market value (as of Oct. 31, 1974)	Percent decrease	Estimated average market value for current fiscal year
22 selected Minnesota foundations.....	\$401,455,000	\$324,244,000	19.3	\$347,050,000

TABLE II.—ESTIMATED INCOME AND DISTRIBUTIONS

	Estimated (adjusted net) income for current fiscal year	Estimated distributable amount for current fiscal year	Amount to be distributed exceeds income, by percent
22 selected Minnesota foundations.....	\$15,766,000	\$17,394,000	10.3

TABLE III.—EXCISE TAX, PAID IN 1973 AND 1974

	Excise tax paid in—	
	1973	1974
22 selected Minnesota foundations.....	\$692,313	\$806,755

A SUBSTUDY OF 14 MINNESOTA FOUNDATIONS' ADJUSTED NET INCOME  
TABLE I.—ADJUSTED NET INCOME FOR CURRENT AND PAST FISCAL YEARS

	Past fiscal year	Current fiscal year	Percent increase
14 Minnesota foundations, total.....	\$12,932,000	\$14,098,000	9

TABLE II.—DISTRIBUTABLE AMOUNT FOR CURRENT AND PAST FISCAL YEARS

	Past fiscal year	Current fiscal year	Percent increase
14 Minnesota foundations, total.....	\$15,511,000	\$15,035,000	-0.1

Senator HARTKE. All right, the next is a panel, David Freeman and Marion Freimont-Smith.

Good morning.

**STATEMENTS OF DAVID FREEMAN, PRESIDENT, COUNCIL ON FOUNDATIONS; AND MRS. MARION FREMONT-SMITH, ATTORNEY, MEMBER, BOSTON LAW FIRM OF CHOATE, HALL & STEWART**

**STATEMENT OF DAVID FREEMAN**

Mr. FREEMAN. Mr. Chairman, Mrs. Freimont-Smith and I are here to talk to you about the problem that has been discussed here frequently and to see if we can provide a little more in the way of statistics than we have had so far, although they still are, as you would understand, very imperfect.

We are going to talk about birth rate and death rate again. We think this is a particularly important subject now because, as Dr. Goheen pointed out yesterday, if the Tax Reform Act and the double bind of the economic recession and inflation are having the kind of effect we believe they are having on existing foundations, then the only place to look for relief, if it is important that foundations continue to play an important role in our private sector, is to new funds. If new funds are not being dedicated to charity, at least at the rate of those being spent out through terminations, then the gap between resources and needs in the private charitable sector is going to continue to widen.

In Mr. Simon's testimony last year he put together what we thought at the time was the best available estimate on birth and death rates. Since then you have received some additional figures which were shared with us from the Internal Service computer, a machine which has had a good deal of comment over the last 2 days, and our own attorneys working with Mrs. Brinkley of the Foundation Center here in Washington, have come up with some representative samplings which I will describe very briefly and ask you to glance at the appendix of my written statement.

Let me deal first with the samplings and suggest what they seem to show. They include first a numerical count of the creation and dissolution of foundations in 12 States for the years 1968 to 1972. These 12 States represent, we think, more than 50 percent of all of the assets in the field, and therefore are perhaps fairly representative of what is happening in terms of the birth and death rate.

The figures show very consistent patterns: new foundation creation dropped sharply from 1968 to 1970, then leveled off at approximately one tenth of the rate of 1968. Terminations increased between 1969 and 1971 and then leveled off, but again, the rate of termination was eight times higher than the rate of termination in pre-Tax Reform Act years. These figures seem to confirm what Mr. Simon's testimony indicated, and in fact, suggest that the situation may be now somewhat worse than his estimates indicated.

Let me digress from my prepared statement here to mention my reaction to one question that you raised, Mr. Chairman, yesterday on this general area. You suggested that perhaps we should not blame the Tax Reform Act for everything that was happening to the foundation world, and obviously that is true. We are in a recession. But I think these birth and death rate figures are nevertheless quite significant because the big changes in the birth and death rate occurred in 1970 and 1971, before we entered what we now recognize as at least a recession, and in fact, before we hit an alltime high on the Dow Jones, so that if other things were equal, there was still money there to be dedicated to charity and no reason to suspect, had there not been the Tax Reform Act in the picture, that there would have been this very striking change in the pattern of birth and death.

You remember that Mr. Goheen referred yesterday to a diagram, and this is the diagram to which he referred which shows a tremendous change in birth and death rates immediately after the 1969 act, and really a reversal of roles. So we think there is a pretty clear cause and effect relationship between these birth and death rate figures and the Tax Reform Act, and Mrs. Fremont-Smith who is a practicing attorney with long experience in this area will give you some of her own personal reactions to this.

Let me move on quickly to the figures that were also sampled by Caplin and Drysdale and the Foundation Center here relating to those foundations that were studied in the 1965 Treasury report.

The survey on those indicated that since the 1965 report which picked up foundations in about 1962, 81 percent of those foundations that were then considered to be private foundations, although the term was not then defined, were classified still as private foundations in 1972; 5 percent had achieved public charity status, and 12 percent had dissolved. The 12-percent dissolution rate is not too alarming.

What is alarming is that two-thirds of those dissolutions occurred in the 3 years following the passage of the Tax Reform Act.

Now, let us look quickly at some of the figures that the computer gave us from IRS. The first is a figure of \$977 million as the assets for private foundations identifiable as having been established since the act. The second figure which is of significance, is that the total asset value identifiable for the 4,900 private foundations that have terminated is approximately \$83 million. If we compare the \$977 million with the \$83 million, we would feel very optimistic about how things were going, and we really should not be here testifying about birth and death rate problems. We cannot take that optimistic view of the situation.

We feel that on the death rate side the total number, 4900, is probably very accurate and alarming just in itself because it represents about 15 percent of the total number of foundations that we figure were in existence in 1969. So there has been a real diminution in numbers, but we would also suggest that the \$83 million figure for the assets is a vastly understated figure for some somewhat technical reasons which I will not go into in detail, but simply to say that in the typical termination process, a foundation will begin to terminate by giving away more than its income by sizable percentages 2 or 3 years before it finally winds up, and if we understand what is in the computer, though heaven knows we do not fully understand that, the probability is that the computer reflects only the figures that were filed with the Treasury in the last year. So we think that there probably was a much greater loss to the field over the 2 years or 3 years, perhaps, during which each foundation was liquidating than is reflected by the figure for the final year.

Now, let me just suggest that we may be able, if the computer is willing to cooperate with us, to get a little better figure on that because the Tax Reform Act does require a filing as to something known as substantial contractions. In other words, when this liquidation process starts, if a foundation gives away a sizable amount of money in terms of its overall assets, that must be reported as a substantial contraction, and we think that hopefully the computer may at some point be able to identify those figures and tell us what they are.

Now, let me turn to the birth rate side. We recognize that we have not yet gotten a breakdown between the operating and nonoperating foundations and we do not really know how many new foundations have been identified, but we do have this startling high figure of \$977 million. We suggest that even though that figure looks very high, it is not high as against the actual rate of growth of the foundation field, pre-Tax Reform Act, when the very rough figures we are able to track back there indicate that on an annual basis there was a growth which was probably as much as a billion dollars of new money. But again, these are very inexact figures because we cannot distinguish between the new money and the market growth of the assets of the foundations that were already in existence.

However, on the other side of this \$977 million figure, we think there are some things that can be said that suggest that it is much too high, and what we tried to do there, since the computer was unable to identify even the top foundations in the new dollar figure, was to work with the Foundation Center to identify from their new directory which

was in the process of preparation, a number of organizations which will meet the directory standards of being either \$1 million in assets or more, or giving away a sizable amount each year, and see whether looking at those identifiable organizations that are in that new directory for the first time, we can determine how many of them were in fact new money, and on that basis we did a check of seven of the largest ones on their list and did the check through Marion Fremont-Smith and another very cooperative person in Chicago who was able to check back to some of the original trust instruments, and found that of the seven that we tried to do the spot check on, six of them had in fact been in existence before the Tax Reform Act, and in fact one of them, as my written statement suggests, was created in a will written in 1933, and had been giving away money to charity with the appropriate reports since 1966.

Now, we cannot swear that these particular organizations are in fact in this new money, but we are very suspicious that they are.

The other kind of area where we think this figure is inflated is where a foundation makes a grant to a new organization and that new organization fails to qualify as publicly supported. Therefore, under the way the definitions work, it itself is a private foundation and could well be classified as a new private foundation even though it represents a grant from another foundation, and it in no sense is new money coming into the field. And we feel that there are some of those organizations in this pool of funds such as the Drug Abuse Council, the Police Foundation, the National Friends of Public Broadcasting.

All this is really to say that the new IRS figures seem to raise at least as many questions as they answer, and that without more analysis, we cannot be confident that they represent a net inflow of new money into the field. In fact, our own samplings and indications lead us to the opposite conclusion.

Thus it is vital that steps be taken to remove some of the disincentives which Mrs. Fremont-Smith will describe. And let me say by way of introduction to my fellow panelist that Mrs. Fremont-Smith is a private practitioner in the Boston area with a good deal of experience in the exempt organization area particularly, and is currently serving as vice chairman of a relevant committee of the ABA, which is active in this area, so that she has had some very direct acquaintance with some of the problems we have been talking about.

Thank you, Mr. Chairman.

#### STATEMENT OF MRS. FREMONT-SMITH

Mrs. FREMONT-SMITH. You can see from Mr. Freeman's discussions that the statistics that have been available to us so far are quite unsatisfactory as to birth rate and death rate. I would suggest that if you look at this from the point of view of an attorney describing to a client who wants to establish a new foundation what is involved in terms of the tax laws, the answer is very simple in terms of birth rate. You tell him that if he wants to give his gift to a publicly supported organization, such as a private university, a hospital, he can deduct up to 50 percent of his adjusted gross income for his cash gifts. He can also increase the gift by using a 5-year carryforward. If he is giving appreciated property, his deduction is for the full fair market value of

the assets on the date of his gift. Although his percentage then will drop from 50 percent to 30 percent, he still can use the carryforward.

The donor to a private foundation, however, is in an entirely different situation. His deduction is limited to 20 percent of his adjusted gross income. He has no carryforward, and if he wishes to give appreciated securities, he may deduct only his basis, plus one-half of the appreciation. Therefore, the deduction provisions above are a great deterrent to an otherwise willing donor.

Now, it is true that these same discrepancies do not exist in the case of testamentary gifts, although there have been some discussions I am aware of in Congress about making a change in this area. In other words, for estate tax purposes there is no difference whether you give to a foundation or to a publicly supported charity.

However, for the individual whose chief asset is control stock of a corporation, the excess business holdings rules or section 4943 discourage both the intervivos and the testamentary gifts by requiring that any excess business holdings be disposed of within 5 years of the gift. In times of economic uncertainty, this puts a terrible strain on the foundation. It diverts the foundation managers from doing what they should be doing in the first years, which is concentrating on setting up meaningful programs. What they are looking for is a buyer for these securities.

I think that what is striking here is that the foundations existing before the Tax Reform Act were given from 15 to 25 years to do what we ask foundations receiving new gifts to do in 5 years.

A donor might say, well, I understand Congress did not like foundations and did not want me to make this gift, but that is all right. I still want to establish a foundation. Maybe he will say I really want to look toward a range of possibilities for my money in the future. I do not want to commit it to X University or Y Hospital, and I do believe that this is what is in the mind of people that I have discussed this with.

Then you must start to describe the Tax Reform Act and the rules dealing with the operations of private foundations. I have not found any clients who felt that the self-dealing prohibitions, the prohibitions against jeopardy investments or the taxable expenditure provisions, were a deterrent in any way. The items that were of concern were the 4-percent tax and the payout rules. And I know that you are aware of the operation of the 4-percent tax. For the person who has not thought about it before, there is an immediate reaction, "how can anybody tax charity?" It is just such a change from our tradition. And it very much goes against the grain.

In regard to the payout, we are in a different situation. Here your potential donor is going to say that he does not really understand how you can invest prudently while trying to meet a payout rate based on one year that in fact was an atypical year. Now, actually, this objection to the payout rule applies to all foundations, whether new ones or old ones. However, for a new foundation, the payout rate is applied immediately. There is no transition period similar to that permitted for pre-1969 foundations, so that you are trying to think about immediate problems of meeting that payout at the same time that you really should be thinking about developing meaningful policies for the future.

Probably the greatest drawback to the payout for someone who is contemplating a foundation, however, is the difficulty of foreseeing a positive future role for foundations.

In my State, one gets a little different perspective from dealing with many old charitable trusts that are now foundations, private foundations. And foundations, I have assisted in terminating several that were established in the middle 1800's, in the early 1900's when no one got a tax deduction. They were doing it for other reasons.

The idea for these donors was to have the juries play a meaningful role in future times. With new rules, when a donor sees that this may very likely not be possible for their gifts, it is an important consideration.

I have been talking about hypothetical donors and hypothetical situations. Now, on a quantitative basis, I would like to describe my actual experience. (I do not really feel I should talk for other people.) Since the 1969 act I have created exactly two private foundations, both of them established with token assets and designed to be in existence with an exemption so that the donors could then plan a large testamentary bequest. In each case, however, after the death of the donor, when the provisions of the foundation are such that it will then terminate, in one case because the organization will be running an adult community center that will be receiving membership fees from the public, and in the other because it clearly will be supporting and supervised by other public charities, thus, these are not private foundations, or foundations in the accepted sense of an organization that has a freedom of action and can move into innovative fields that we have been describing as perhaps the most important rationale for foundations.

On the subject of terminations I will only say briefly that I have participated, in a large number of them. Each reflected in great part a reaction to the complexities of the provisions of the Tax Reform Act, particularly, a desire to avoid the 4-percent tax, but, also, the additional administrative expenses that would be required to operate under the new rules.

In certain instances where the creator was still alive, he could no longer envision current gifts, particularly of appreciated property, and therefore the managers felt there was really not much reason to continue.

Finally, there is a statistic naming how many gifts to foundations have been lost because many wills have been revised to revoke gifts to foundations since 1969.

In other words one must think of birth rates and death rates together, and I can only believe that (coupled with another area that I really do not feel I had time to go into today, which is the limitations on creating charitable remainder gifts), there has been a great diminution in the total amount of gifts going to all of charity since passage of the Tax Reform Act.

In short, the conclusion inevitably, is that Congress in the 1969 act effectively blocked the continued presence of private foundations as a major component of private philanthropy. In doing so, I think they created a major change in the entire field of philanthropy; one that was not discussed, and one that I am grateful has been a topic for discussion today because what we are really talking about is whether we



want to preserve private philanthropy in its entirety as an institution, or do we feel that Government should do it?

Well, there should be no question in your mind as to how I feel about this. The positive aspects of it have to do with private initiative. They have to do with any donors as to whether Government should fulfill the needs of society, now provided by philanthropy, and if yes, whether it can.

However, if you decide you do wish to preserve the entire field of private philanthropy, then it does not make any sense to treat private foundations as second class citizens because it is the foundations that provide the money to create new organizations that are designed to meet future needs.

In other words, when there is a new need to be met and you wish to organize a publicly supported organization to assist. How do you do this? You go to the foundations for some of the money to get started. The Government is not going to give it to you and you are not going to be able to mount a fund raising drive to get the public support that is considered the desiderata for being a "good" charity, unless you have some funds to start.

I repeat, it is my hope that we will preserve this unique aspect of our society with its complexity. But if we are to do it, the first step now is to remove some of the disincentives that I have been describing. It is my opinion that we can keep the opportunities open to meet future needs, whether they are supported through the private foundations, or ultimately taken over by publicly supported organization.

Thank you.

Senator HARTKE. Is it your judgment then that if you eliminate the tax subsidy that private philanthropy would end?

Mrs. FREMONT-SMITH. If you eliminate all deductions for all charities?

Senator HARTKE. If you eliminate the tax subsidy for charitable donations, foundations, and otherwise, would that be the end of the entire movement?

Mrs. FREMONT-SMITH. I think that would be the end as we know it today, no question about it.

Senator HARTKE. Well, you see, you put your finger on it. I do not think it is quite fair to say whether or not you want to preserve this private giving because as far as a donor is concerned, he is getting the benefit in giving.

Now I am not saying he should or should not, but I think you are down to the heart of it, which ultimately, which I have kept on saying here, has to be decided by the Government. If you have a diminution of the total tax collection, or putting it another way, if you have a subsidy to givers, you then have to show that this is something which has a social value.

In other words, I do not think you can say it is simply social value when the person has a tax advantage to do something. It may be a social value but if you are telling me that if the donor is denied the taxable benefits, that private giving will come to an end, then you know that is the old, old story about the widow's mite. Now a rich man gives from his abundance. I guess you know that story. If you do not, I would be glad to give it to you. It is about 2,000 years old.

Mrs. FREMONT-SMITH. I would say first of all that I really, would prefer not to talk about this as a subsidy.

Senator HARTKE. Well, I know that shocks you, but—

Mrs. FREMONT-SMITH. Well, it is not a question of—

Senator HARTKE. You talk about it as a tax benefit. Just talk about it as a tax benefit. That is what you do as a lawyer. I am a lawyer, too. What you are doing is you are giving him a tax benefit.

Mrs. FREMONT-SMITH. Yes, but he has a choice. He either makes his charitable gift or he does not. If he does not make the charitable gift, he pays a tax.

Correct?

Senator HARTKE. That is right.

Mrs. FREMONT-SMITH. If we take away the incentive, that does not mean that the money will go to Government. The Government does not tax it entirely. It will be used for private purposes. The point of allowing the deduction, if you look historically, as I understand it, was that we believe that this was a positive thing that we wanted for our society.

Senator HARTKE. Is that not the essence of these hearings?

Mrs. FREMONT-SMITH. Exactly.

Senator HARTKE. The essence of these hearings is that that decision is to be made.

Mrs. FREMONT-SMITH. That we are reviewing a decision made many years ago.

Senator HARTKE. You are talking about that decision that was made, in part, in 1969, and that decision so far has been detrimental to foundations.

That is what you are saying.

Mrs. FREMONT-SMITH. No. I think what I was trying to say, sir, was that we have made a decision going back to the early 1900's when the first income tax law was passed.

Senator HARTKE. No, no, I am talking about the criticism today. What you have stated today is directed at this 1969 law, not prior laws.

Mrs. FREMONT-SMITH. That is correct, but my criticism goes—

Senator HARTKE. And the criticism is directed at the fact that there was a decision made by the Congress that if you are going to have this tax benefit, then there are certain rules you are going to have to live with. And if you do not want to live by those rules, then you cannot have the tax benefit. Now that is the decision. It may be right, it may be wrong, but that is the decision. Now what we are reviewing now is whether that decision was correct. Now I will tell you that I think that the 4 percent amount was wrong, but I do not think the audit provision was wrong. I think it is only a mistake as to the amounts.

Mrs. FREMONT-SMITH. I quite agree with you.

Senator HARTKE. Now the point I was going to come to very simply to you is, if you are telling me I have to defend the private foundations on the basis simply of, and this is a question which I was addressing in a different fashion to Landrum Bolling, but if you are telling me that the only reason that the donation is being made is because of tax benefit, then you come back to a very hard nosed question which I was discussing with you last night, and that is very simply that when you are coming back to using taxpayers' moneys, the taxpayer has a right to know what happens to it.

Mrs. FREMONT-SMITH. I would not argue with you in any way about the importance of having better and tighter Government supervision of philanthropy. I discussed this before you a year ago.

What I am saying is that my primary problems are with the differential between the deductions for the gifts to private foundations and the deductions for the gifts to publicly supported organizations because I think they change the whole character of the philanthropic field.

Senator HARTKE. It was intended to.

Mrs. FREMONT-SMITH. I understand.

Senator HARTKE. The law was intended to change it. It was very definitely intended to change the concept of how people were donating money to foundations and how foundations were paying the money out. That was what the law intended to do.

Mrs. FREMONT-SMITH. Well, the law is intended, if you want it in that sense, to say, "Let us not have any more private foundations."

I am saying that—

Senator HARTKE. Well, that decision was almost made, you know.

Mrs. FREMONT-SMITH. I realize, but I am afraid—

Senator HARKE. Some people have said that, instead of deciding to put an end to foundations, Congress gave them a slow death sentence. And that may be true and I think that is really the complaint here, as I understand it. Basically the foundations are complaining that the present law is going to cause an ultimate dissolution of the foundations.

I have to admit that I find very little reason and justification for the differentiation in the law between public charities and foundations. I would definitely have to say that I think you make a good case. I mean you make a good case on the question of being treated as second-class citizens in this regard. But that is not the question I keep on asking. I keep on asking the question the answer to which everyone either skirts or does not know, and that is what is the justification for the existence of foundations. It is important for foundations to identify with some national purpose because you are taking taxpayers' money and using it for private purposes.

Now the very organizations which come here before me, I will guarantee you that 90 percent of their donors say, do not have the Government interfering with private business. But at the same time they want to take taxpayers' money and not account for it.

Mr. FREEMAN. Mr. Chairman, may I try and answer that?

Senator HARTKE. Yes, sir.

Mr. FREEMAN. It seems to me it is quite clear that one of the most beneficial effects of the Tax Reform Act was to improve the accountability, and if I may repeat your last statement you are suggesting that the donor takes the tax benefit, if we can use that phrase, and does not account for it. It seems to me that he is now required to account for it and required to account for it much more effectively, particularly if we ever get that computer properly programed than was ever the case before the Tax Reform Act, and as you know, the Council and the Foundation Center has been trying to encourage all our members to do more than the act required, and that is to tell their story as completely as possible to do so, and it seems to me that is a very, very beneficial effect of the Tax Reform Act.

We are not saying that everything that happened in 1969 was bad for foundations. We think this was very good for them. I think the kind of oversight hearings which this subcommittee is holding would not have happened had there not been a Tax Reform Act to draw attention to this interesting area of private foundation giving, and I think that these hearings are also very helpful. They challenge us to come up with, if not one monolithic philosophy, at least a number of individual philosophies to try and ask ourselves some searching questions.

I think, though, that there is one point here that we are missing a little bit in our discussion of the birth and death rate problem, and it is one that Landrum Bolling brought out earlier this morning and which I think is terribly important and which I think basically you agree with, Mr. Chairman, and that is that what we need in the private philanthropic sector is flexibility.

It is perfectly logical to me, having worked in the foundation world for most of my career, to say that if foundations are nothing more than neutral middlemen and are just passing the money from the donor to two or three selected charities, they are not really performing anything that makes it worthwhile being there. But if, in fact, they can provide the kind of approach to present day problems which a donor in his will recognizes that he could not possibly foresee, then it seems to me there is still a strong reason for the donor to create new foundations by his estate and perhaps to do it *intervivos* so he can begin to get a feel for how it is going to go and so forth. And if those new foundations—not all of them, certainly, because man is not perfect—do perform reasonably well, then we have something that John Simon laid some emphasis on a year ago. We have an influx, not just of new money but of new minds into the field, which it seems to me is a particularly important thing as we look at the kinds of problems that all of us are struggling with. Some of us who perhaps have been in the field too long seem to find some of these same problems confronting us that confronted us 20 years ago, particularly in my case in the race area. And I must say I think foundations have done as well in that area as could have been expected of them, given the troubled times we have seen.

But they certainly have not solved the race problem in the last 20 years. It is still there and I think it is going to be with us for some time to come.

I hope that new foundations will come along to tackle that precise problem perhaps with new ideas and with new money, not necessarily big money. And I am very concerned that the effect of this Tax Reform Act, not necessarily thought through at the time of the enactment of the bill, was to make it very difficult for the individual donor to see that this is a useful way of putting his money to work.

Now we have got some interesting figures that will be coming through the Filer Commission which suggests that on your quantitative basis, Mr. Chairman, there may be something quantifiable and I am not going to try to play the role of the economist and describe it to you. Let me just say that there seems to be an indication that the charitable contribution across-the-board, not just the contribution to foundations, produces more money than it costs the Government. So

that even if we assume that the private money was being spent no less effectively and no more effectively than Government, nevertheless, the effect of a charitable contribution seems to be to draw more money into the field than the taxpayer is saving.

Now that to me is something that the economist should tackle and they are tackling it from the Filer Commission and we will hear more about it. But in that context, I think, the private sector is still a valid one, and I would be very sorry to see the private foundation part of that, small though it is, hampered, as it seems to us to be by these provisions.

Senator HARTKE. Let me say that I appreciate what you have said here, and I want to also extend my thanks to you for the cooperation we have had from the Council because it has been very worthwhile and we do appreciate that. And also, the idea you have on substantial contractions, we will ask the IRS hopefully to get into that.

And on that subject, all I can say is I just hope the Internal Revenue Service moves a little faster than they have in the past and that we do have some answers to some of these questions which, frankly, no one has at this moment.

Let me ask you, do you think that we ought to put on the annual information return of foundations the date when the foundation was created?

Mr. FREEMAN. Yes, I think that is a very useful thing to get on there. It is something that the Foundation Center has been urging IRS to put onto its forms. It was something that was on the forms several years back and has been dropped off in the interest of simplicity, presumably, even though the form has grown by about 200-fold. I do agree that that figure ought to be contained in the information return.

Senator HARTKE. Senator Gravel?

Senator GRAVEL [presiding]. Thank you, Mr. Chairman. I would like to focus a little bit on the matter that the Chairman was talking about and address myself to you, Counselor, and to the point that you are making about the imaginative programs that may be foregone right now. I was not on the committee at the time, but I know the philosophical base with which I voted for the proposal in 1969.

Dealing with this philosophically, suppose a person has \$100 million he wants to give as a gift and he has a choice—he can either give it as a gift or pay taxes—lose it through taxation. And so I am fully prepared as a policymaker to say that if somebody is willing to do that, that is fine. You get imaginative cross-fertilization in society.

However, it comes to the point—which was the inertia behind the legislation in 1969—where we now, in order to get that person to give a \$100 million gift and forego the taxes, allow him to make a choice rather than we—the Congress—make a choice as to what happens to that money. Do we have to give him a tax benefit that inures to him, or is he willing to give the \$100 million and take the decision of the use of that money out of the hands of Congress? He will only do that if he can get a tax “rip-off” for himself that inures to him in his lifetime. Otherwise he has no incentive to give that gift.

Now if the Congress in the 1969 act passed it at that equilibrium, then the true test of a gift—and I do not know if it was passed at the

equilibrium, but if it was not, then obviously, there would be a deterioration in the number of foundations. But I was impressed by the statement of the young man who preceded you, who cited the facts about the life and the births and deaths of foundations. Maybe a lot of foundations should have died, and should never have been born, because their motive in force was not necessarily very good, only that some tax benefit would inure to an individual, or they could manipulate the use of this wealth.

And those are the things that I voted against in 1969 and I do not want to see them recur. But until somebody can make a persuasive argument that in this balance there are people giving because they really want to give and are giving thought to the purpose of that gift, I cannot support such an incentive. If they are, then I am prepared to let them dispose of those tax moneys because they are tax moneys. Because if they did not use it for gift purposes, we would get them, and then we would appropriate them for whatever programs we want. That is our job.

So I am prepared to forgo that power and give it to somebody else if he is prepared to give thoughtful consideration to the gift. I would suggest that the test for that thoughtful consideration is whether or not there is a benefit that inures to him. If my motive is to give the gift because I can get a tax benefit, I am not really interested that much, maybe just cursorily, in devising a new wheat program, or devising something for child abuse, or trying to solve a problem for the indigenous people of maybe Bethel, Alaska. That is not my first motive. My first motive is "I am going to get a benefit and then maybe I will think of something to spend the money on after I get somebody to think of something to spend the money on." And I think that that part of it goes downhill very rapidly from the point of view of information.

Mrs. FREMONT-SMITH. Let me say first of all, in the area that I was talking about, which is the amount of the deduction, there is no way anybody can make money by giving to charity.

Senator GRAVEL. Was that the case prior to 1969?

Mrs. FREMONT-SMITH. Yes.

Senator GRAVEL. But prior—

Mrs. FREMONT-SMITH. I am saying before that, but since the Tax Reform Act with the entire range of changes in section 170—

Senator GRAVEL. Let me ask a question for my own edification, Counsel.

Mrs. FREMONT-SMITH. OK.

Senator GRAVEL. Prior to the 1969 act it certainly was within the law for an individual to give money as a gift and not pay taxes on that money and actually accrue in addition to that action a benefit to himself.

Mrs. FREMONT-SMITH. Yes. I was talking in terms of the net monetary gain, but I understand what you mean.

Senator GRAVEL. Yes, I just wanted to make sure that I know where we are to start with.

Mrs. FREMONT-SMITH. May I just give you a little bit of background as to how I came into this? It might explain the way I approach it.

I was director of the Division of Public Charities in Massachusetts and an assistant attorney general and my job was similar to that of

the Internal Revenue Service, but with a broader framework of trying to assure that there was proper behavior by all charitable organizations and not just foundations. I was aware of the types of abuses that you are talking about. They have to do with the fact that basically the tax laws were not policing what we had under State law, which was a prohibition against self-dealing and a prohibition against using charitable funds for your personal benefit. And therefore, I was very strongly in favor of those provisions of the Tax Reform Act that you have just described which do reduce the ability of individuals to take that kind of private benefit or to give money for charity and then continue to use it for their own purposes.

I will never quarrel with those. I believe strongly in the accountability provisions and the reporting provisions. But at the time of the Tax Reform Act we went too far. We did all of that but then we went farther, and we said that because there were some abuses in the past, we are now going to create second-class citizens in terms of the deduction provisions and we are also going to take 4 percent of the money back for Government. In addition to that, we are not going to look at the long range needs of our society that charity has always attempted to fulfill, and we are going to demand an immediate payout.

Well, we started with that concept and I have no quarrel again with requiring a current payout of a fair return on the investments of the foundations. But what you got was a rate of payout that is unrealistic, if you are looking toward preserving foundations as an institution, so it is the overreaction in the Tax Reform Act that I am asking to be reconsidered and not the entire thing at all.

Senator GRAVEL. And I share your view. There is nothing that you have said at this juncture that I disagree with. I wholeheartedly support it. I would probably be against the regressive tax. I was not aware of that in great detail. Certainly the rate of payout, a case could be made to correct that. But I was only addressing myself to the first part of your presentation where you stress that people were discouraged from giving a gift. Maybe they were discouraged by these items whether you were giving a gift given prior to the tax or that was a gift truly given for a gift. And I know, and I think you know from your experience, which is broader than mine, a lot of people did not give for giving; they gave for the taking.

Mrs. FREMONT-SMITH. I would say that is rare. I just do not believe there are a lot of people who acted that way, although there were some.

Senator GRAVEL. Well, there were enough to warrant such an outcry in the Congress for Congress to do something. The only reason Congress does something is because the people want it. We do not initiate imaginative things. Usually, they do not sell very well to the public.

Mr. FREEMAN. Well, Senator, I think some of the things that were giving Congress the most concern in 1969 had to do with what we talked about just now as the abuses rather than the question of tax incentives. And we come back, I think, to the feeling that most of the abuses that were at least potentially available in the private foundation mechanism have been pretty well cut off now. The best indication of this, it seems to me, is found that despite the most intensive audit program that has ever been conducted in the exempt organization field, at least, with 100 percent of all private foundations theoretically

audited by the end of this year, the actual dollar penalties are not very astounding.

So I think that part of the legislation is working. And we come back to the question of whether the second-class citizenship, which we have referred to here, is not a matter of overkill. If it is a matter of overkill, then the person who has got a real charitable instinct and wants to give his money away as intelligently as he can, is faced with a very peculiar Hobson's choice. He has to either give the money to a private foundation where in fact it is going to be taxed and he is not going to be able to give as much in terms of his estate planning because of the limitations.

Senator GRAVEL. The tax of 4 percent?

Mr. FREEMAN. Yes—and he is not going to be able to give as much in his lifetime because of the limitations or he is going to have to give it to one or more existing publicly supported organizations which are first-class citizens. And it is that kind of distinction that troubles us.

Senator GRAVEL. Let me state again. I want to correct the deficiencies as much as you do, and I accept the deficiencies you outlined right there, but can you answer this question?

Can you tell me whether the atrophication that has taken place in births and deaths, the contraction in the whole foundation area of our society, is due, one, to the beneficial aspects of the Tax Reform Act or to the overkill aspects of the Tax Reform Act?

Can you tell me what percentage of people are not going into foundations now, are not going in because they cannot rip it off or because they feel hurt that the Government is going to rip them off for 4 percent of the money that they want to make a decision on, which, if they did not donate at all, the Government would make the whole decision on?

Mr. FREEMAN. Obviously, we cannot be more than subjective on that question, but several of the foundations that Landrum Bolling mentioned by name and others that we know, some of our own member foundations, which almost by definition were taking their roles seriously or they would not have thought of joining the Council, have in fact terminated and they have terminated not for reasons of not being able to get away with something but because they have just felt that the kinds of charitable things they were trying to do were being hampered or because in some cases the foundation's role as the mechanism for a family's giving during the family's active giving period, was no longer useful.

Here you have got the strange anomaly of a wealthy family finding a foundation, not a place to put the money away indefinitely but a place where they could make gifts of stock primarily and then have those gifts liquidated, in effect, by the foundation and paid out to charity within a couple of years. Very frequently, this is a flow-through situation and those kinds of foundations have had a utility because often the smaller charities are not in a position to handle gifts of stock and this may sound like a silly problem but it is a real problem.

Senator GRAVEL. I can appreciate that.

Mr. FREEMAN. You have got a small charity that is suddenly given a stock certificate. It does not know what to do with it. So that kind of small foundation—it may not have had a staff, it may not have built



an elaborate program was nevertheless providing a useful conduit mechanism to get money from a wealthy family to charity.

I think a number of those have folded. I do not think it is a major loss to the field but it is a loss in the sense that we—

Senator GRAVEL. Well, they do not want to see their stock dispersed. Is that it? If they have, let us say if they have got a family corporation and—

Mr. FREEMAN. Well, that is another problem. The problem I was relating to did not necessarily involve closely held stock but the problem that Marion Fremont-Smith was referring to earlier is more in terms of large gifts of stock to a foundation either *inter vivos* or by will where it is control stock.

Mrs. FREMONT-SMITH. The controlled stock issue was taken care of under the Excess Business Holdings Provisions of the Tax Reform Act, and the only objection I was raising there was that there is too short a time under the transition rule to make sense.

Senator GRAVEL. Could I ask a question philosophically?

Mrs. FREMONT-SMITH. Yes.

Senator GRAVEL. If a person, you say, was discouraged by the 4 percent and a person wanted to give to a charity and wanted to exercise some thoughtfulness on how this money is to be used in society, why would he be discouraged even if he is penalized—and I use the word “penalized” in its proper form here based on your testimony—even if he is penalized 4 percent? And he will say: “Well, no, I am not going to do it because I am penalized 4 percent, so I will let Government make all of the decisions. I will let them make 96—

In other words, they would rather trade off 4 percent for 96 percent. It does not seem right. If that is such a discouraging item—

Mrs. FREMONT-SMITH. Well, sir, I think there are two parts to that. One of them, as I was trying to point out, is the discrepancies between your gift to a publicly supported organization and to a private foundation. Given the choice your client is going to say, “If I give it to my college, I can even give them controlled stock and nobody is going to force them to dispose of it. But if I give it to a private foundation, there is a 4 percent tax on the income before anything is used for charity. Why should I make that choice? Why should I subject this money to tax when what I really want to do with it is have it go for a philanthropic purpose?”

And I am talking about the donor who has no intention of keeping any control on it in any way. I am not talking even about the situation where the donor, or members of his family will be on the board of the foundation. And they say, just from a basic sense: “Here is one charity, I can do it with no 4 percent tax. And here is another.”

Senator GRAVEL. Well, I think, Counsel, we would have to, in order to make a judgment in that area we would have to have more of a statistical basis for it than would be your experience of—

Mrs. FREMONT-SMITH. Well, I understand. No question about that.

Senator GRAVEL. Do I have agreement from you—and I did get a response on that—if a person gives \$100 million, wants to give it to foundations, that there should be no benefit that accrues to him at all, that the true test should be desire to give? Or do you think maybe the Government should support foundations by giving an incentive to the individuals to give it to a foundation because he gets a benefit?

Mr. FREEMAN. Senator, it depends a lot upon what you mean by benefit. If what you are talking about is personal benefit in terms of being able to so direct the use of those funds that, you know, in the most egregious cases, his uncle's son gets a scholarship to go to the college, or something like that, then I would say flatly no, and that is what I think Marion and I both agree on.

Senator GRAVEL. I was thinking of a more general—

Mr. FREEMAN. The self-dealing rules are working. They are important; they are going to help the foundation field because they are working.

If what you are saying is that the benefit in terms of a charitable deduction on the individual's return is something that he should not take into account, then that gets into a much more sophisticated problem where he really is facing a series of alternatives in planning not only his lifetime giving but his estate, and if his chief motivation is a charitable one, he may find that it is to the advantage of charity in terms of where the final dollars go to give to the first-class citizens of charity rather than to the second-class citizens, so that on that kind of a choice, we feel that the foundations should be brought up to first-class citizenship. We do not urge that the charitable deduction be done away with.

Senator GRAVEL. No, I understand that point. I understand very well. I grasped it very early.

But you are not responding to my question, and the philosophical point that I am making is, should we as government—do not look at it from the point of view of the foundation, look at it from our point of view—people who have charge of the total Government, should we provide an incentive to cause people to put their money into charity, or should the desire to do something charitable be sufficient to satisfy that need?

Mr. FREEMAN. I think that the answer is an unqualified yes, you should supply an incentive, which is a traditional incentive supplied by the Government long before the income tax, and the fact is that the real property tax has a charitable deduction. What you are really doing by supplying that incentive is strengthening the pluralism that we have been talking about here.

Senator GRAVEL. That is a valid point.

Mr. FREEMAN. You are encouraging other points of decisionmaking besides central government, and I would strongly urge you to continue to do that.

Senator GRAVEL. Now that is something that is very important that has been brought up because up until this time we had focused on that.

Now it is your position—and I am not quarreling with it; that may be well the case. That may be the only way we can get an adversary system working in this country effectively.

Mr. FREEMAN. Let me put it the other way if I may, Senator. I think it is one of the real reasons why we have had such a system working and that it does work reasonably effectively, and I think that a number of the developments over the past few months can be traced back one way or another to the fact that we have had different centers of power.

Senator GRAVEL. Can we now focus on how much of an incentive should we provide? Should we say that a person can give \$100 mil-

lion that the Government is deprived of from spending? The individuals, the private individuals will now spend that \$100 million because that is a gift. In order to effect that transaction in society, what benefits should accrue to the first party, the giver, in order to effect that gift, what should it be? A 5-percent incentive, a 10-percent incentive?

You see, rather than let it go into ego-incentives or manipulative incentives, it would be better off for us as policymakers seeing what it is and paying the cost of doing that, arriving at that goal. In other words, if we can find out and identify whether these births and deaths really are happening, whether it is actually an indication of doing away with an abuse—now that it is good, and how much abuse do we want to do away with? Do we want to tolerate what people used to call an abuse, and now we call an incentive, in order to cause this pluralism or the ability to pluralize ourselves?

So should we give it now a 5-percent incentive and say that I could make—if I am very, very wealthy, I can do these things, but I am going to get a 5-percent benefit that will accrue, that I can experience now. I may be prepared to do that as a policymaker, and with good conscience, because I want to save that pluralism you talk of.

So that is what I think we ought to identify, and unless you focus at that policy level, you are going to get lost in these figures, which are not going to interest anybody else on the floor of the Senate, and you are not going to have anybody to come to listen to you because it is so boring.

Mr. FREEMAN. I agree with you that it is important that you focus on these items. I think we have to be careful how we describe the benefit.

Senator GRAVEL. That is very good.

Mr. FREEMAN. Because the thing that troubles us most with some of the tax theories is that they speak of these benefits as if they flowed only one way, as if when a person took a charitable deduction, he was in a sense pocketing that 30 percent or 50 percent.

In fact he is not pocketing it. He is out money when he makes a charitable gift, and what he is doing is receiving an incentive from the Government to make that gift which we think will turn out to be a very inexpensive way, from the Government's point of view, to be sure that the pluralistic centers of decision are preserved.

Now I cannot give you hard figures on that, but there is a lot of study going on now to determine what the incentives really are for a charitable donation and what it in a sense costs, in terms of the lost revenue, and I think when those figures are studied by the Filer Commission and reported by the Filer Commission to the Senate and the House, it will be very helpful.

Senator GRAVEL. I doubt we could make any—and I know these are exploratory hearings called by the chairman in preparation, I am sure, for the report or the study—but certainly there is nothing we could do, and I do not think we should do, until we get that information because that is really precisely what would be the crux of this.

One: do we want an incentive? I do because I want to see the pluralism take place, but I want to see totally what that incentive is and try to raise it to the proper level, because the other side of the point you are making is that you could provide such an incentive

that people become profligate in what they are doing. If there is going to be any profligacy, I would rather I do it rather than somebody else do it.

Mrs. FREMONT-SMITH. I would say that there are two levels of issues here, however. We have been talking about the difference in incentives for gifts to private and publicly supported—I think what you were talking about and the Filer Commission studies are going to give us finally is this other issue of what amount of incentive for publicly supported organizations can the Senate or the Congress agree to.

Senator GRAVEL. And I accepted your testimony on that a long time ago, and I realize something should be changed in that so that there are no second-class citizens in this area.

I was not saying that. I was trying to focus on what I think was a more important issue. That is going to be the survival of the foundation system in our society. I think it should survive, and I think at least those who have a view do not want to see laws passed that would cause us to diminish them to the point of nothing. I think we want to see it survive and be healthy, but I really want to know what we are doing when we are doing it, not the situation that existed prior to 1969 where there was just profligacy going on wholesale, and people ripping it off when they had no intent of charity, and we do not know how much that was except that your birth rate and death figures tell us somewhere in there how much it was.

Thank you, thank you, Mr. Chairman. I have no further questions.

[The prepared statements of Mr. Freeman and Mrs. Fremont-Smith follow:]

#### PREPARED STATEMENT OF DAVID F. FREEMAN

My fellow panelist, Marlon Fremont-Smith, and I will be speaking today about the death-rates and birth-rates of foundations. As Mr. Goheen indicated in his testimony yesterday, this becomes a critically important topic now, when the assets of existing foundations and the purchasing power of their grants are shrinking. If new funds are not being dedicated to charity at at least the rate of those being spent out through terminations, then the gap between resources and needs in the private charitable sector will continue to widen.

In his testimony before this subcommittee last year, Professor John Simon of Yale Law School presented the best estimates then available on birth- and death-rates. Since then Commissioner Alexander has supplied your subcommittee with new data from the IRS computer, and the Council's attorneys, Caplin & Drysdale, have collaborated with The Foundation Center here in Washington on some representative samplings.

These samplings, attached as Appendix A to this statement, include, first, a numerical count of the creation and dissolution of foundations in 12 states for the years 1968-1972. The figures show consistent patterns: new foundation creation dropped sharply from 1968 to 1970, then levelled off at about  $\frac{1}{10}$ th of the 1968 rate. Terminations increased sharply between 1969 and 1971, then levelled off, but at a rate eight times higher than in pre-TRA years. These figures confirm those in Mr. Simon's testimony, and in fact suggest that the situation is worse than his estimates indicated.

A second sampling, tracing the subsequent history of 1300 foundations included in the 1965 Treasury Report, finds that 81% of them were classified as private foundations in 1972, only 5% had achieved "public charity" status, and 12% had dissolved. Two-thirds of these dissolutions occurred in the three years following passage of the Act.

The IRS figures on the number of private foundations which have terminated since 1969, and those which have been categorized as private foundations for the first time during that period, correlate closely with the figures given by our samplings. However, the IRS dollar totals present a much more optimistic picture

of the flow of new funds into the field than either Mr. Simon's testimony or our recent samplings indicate.

IRS reports aggregate current assets of \$977 million for private foundations established since the Act. And although almost 4,900 private non-operating foundations have terminated since 1969, their aggregate asset value is reported as only \$83,419,652. While these death- and birth-rate data are not claimed to be directly comparable, without further analysis the figures suggest that the ratio of new private foundation dollars donated since 1969 to those lost to the field is quite favorable. We don't think that there is ground for such optimism.

On the death-rate side, the number of terminating foundations—almost 15% of the estimated 1969 total—is alarming in itself. While the assets of those now apparently extinct foundations are reported at \$83 million, the actual assets of these terminating foundations are likely to have been much greater. In our experience, many foundations that decide to go out of existence do so over 2 or more years. So the asset value in the year of termination, the figure presumably furnished by the IRS computer, is likely to be a substantially lower figure in many cases than the assets of these foundations at the time the termination decision is made. Moreover, we assume that IRS termination figures do not include foundations that have distributed substantially all of their assets since 1969 but for one reason or another have not yet filed a final return.

The IRS figure of \$83 million for terminations doesn't jibe with what information we have from potential recipients of such funds. Our own survey of a small group of community foundations over a year ago showed that they had received, since 1969, some \$60 million in assets of terminating private foundations. This flow has continued, and we believe that many other types of public charities have received substantial sums from such terminations.

To get more comprehensive figures on the total assets lost to the field since 1969, the computer might be asked to produce figures on the dollars involved in what the TRA defines as "substantial contractions." These figures, when added to the "termination" totals, may provide a more realistic measure of the death-rate effects of the Act than the IRS data so far furnished.

On the birth-rate side, we understand the Service and the Treasury will provide a breakdown between operating and non-operating foundations, both in asset values and number of organizations, for the foundations created after 1969. At this point, we have only the figures of some \$977 million in assets for ostensibly new foundations.

As Mr. Goheen has already testified, we have reservations about this data. Before explaining our reservations, it would be well to point out that even if accurate, the \$977 million figure for a four-year period is not large compared to estimates available for a decade ago.

In the 1965 Treasury Report on private foundations, the Treasury estimated total gifts to private foundations in the single year 1962 of \$833 million. Over approximately three years (1961-1964) between Editions 2 and 3 of The Foundation Directory, The Foundation Center estimated an annual growth rate for foundation assets of 11.4%, or more \$1.8 billion per year. While these data reflect increases in market value and contributions to existing as well as new foundations, they suggest that the figure of \$977 million for new foundations over the four-year period since the Act is hardly a strong growth record.

Now to the reasons we believe the figure of \$977 million is misleadingly high.

First, we asked The Foundation Center to provide as much data as they could on the formation of new foundations as this information will appear in Edition 5 of The Foundation Directory, scheduled for publication in the spring of 1975. These figures are preliminary, but reliable. Although they receive copies of IRS information returns of all organizations filing as private foundations, they could identify only about 50 organizations that qualify for the size limitations of the new directory (with \$1 million or more in assets or with annual charitable expenditures of \$500,000 or more) with possible post TRA creation dates.<sup>1</sup>

Total asset values for this group are about \$180 million. However, a majority of these may turn out on closer examination to have been established under pre-1969 TRA trusts and wills. A spot check of seven such organizations—totaling about \$52 million in assets—resulted in information in six cases indicating that, in fact, they were created under prior law. As a matter of fact, one of the

<sup>1</sup> In most instances, it is impossible to state the year the organization was created, since IRS forms only call for the year an exemption letter was issued—not necessarily the year in which the organization was formed.

"new" foundations, which acquired exempt status and presumably became a private foundation according to IRS records in 1971, was created under a will written in 1933 and has filed information returns as a charitable trust with appropriate state officials since 1966.

Unfortunately, neither the Council, The Foundation Center, nor, we suspect, the IRS, is in a position to quantify the number of "new" foundations that may fall in this category of private foundations added to the Exempt Organizations Master File since the Tax Reform Act, but are new in no other sense of the word.

Other types of organizations may have been included in the IRS computation of "new foundation" assets which do not represent new money in the field. For example, entities established by grants from other private foundations since the Tax Reform Act of 1969 may not as yet have established public charity status. These organizations are presumably included in IRS records of private foundations created after the Act's effective date. They are new in terms of services they make available but they do not represent new money, in that they have been funded primarily by grants from existing private foundations. Organizations like the Drug Abuse Council, the Police Foundation, the National Friends of Public Broadcasting, and the Washington Research Project—Childrens Defense Fund may fit this description.

In conclusion, it seems fair to say that these new IRS figures on birth-rates and death-rates raise at least as many questions as they answer. Without more analysis, we cannot be confident that they represent a net inflow of new money to the field. Our own samplings and indication lead us to the opposite conclusion—that this flow has just about dried up. Thus it is vital that steps be taken to remove some of the disincentives which Mrs. Fremont-Smith will describe.

---

PREPARED STATEMENT OF MARION R. FREMONT-SMITH, ATTORNEY MEMBER, BOSTON  
LAW FIRM OF CHOATE, HALL & STEWART

You have heard once again this morning of the difficulty of obtaining statistics on the birth and death rate of private foundations. Unfortunately, it is unlikely that we will have definite information for some time. However, one need only approach the subject from the point of view of an attorney explaining the intricacies of the tax laws to a person desirous of establishing a foundation to see that it is only the rare individual who will still proceed to do so.

A person making a gift to a publicly supported organization or an operating foundation can deduct up to 50% of his adjusted gross income for his cash gifts in any year. He can increase the deduction in the year of the gift by using the 5 year carryforward. Should he make a gift of appreciated property, his deduction will be for the fair market value of the property on the date of gift, regardless of his basis. Although the allowable percentage drops from 50% to 30% of adjusted gross income, he may still use the carryforward.

For the donor to a private foundation, it is quite a different situation. His deduction is limited to 20% of adjusted gross income. If he gives appreciated property, he can deduct only an amount equal to his basis plus one-half of the appreciation. He might use the pass-through provisions of the Code if he and his advisers dare to tread the maze posed by the regulations for a gift of this nature; but pass-through gifts do not create an endowment for a foundation nor permit the additions of capital to old ones. Finally, there is no carryforward for any gifts to a private foundation. Thus, the discrepancies in treatment between gifts to a publicly supported charity and those to a foundation cannot help but deter an otherwise willing donor.

It is true that these same discrepancies do not exist in the case of testamentary gifts. For estate tax purposes, there is no similar disincentives so long the gifts are of cash or of small holdings in widely traded securities. For the individual whose chief asset is control stock of a corporation, however, the excess business holding rules of Sec. 4943 discourage both inter vivos and testamentary gifts of these assets by requiring that the holdings of the foundation, the donor and his family be reduced to no greater than 20% of the value of outstanding stock or the value of the business within 5 years of the gift. This transition period is totally impractical, forcing quick secondary offerings at a sacrifice if, in fact, the economic situation is sufficiently viable to permit the foundation to find any buyer. It is, furthermore, ironic that for a newly created or funded foundation, the 5 year divestiture period comes at a time when the attentions

and energies of the foundation managers are most needed for program development. In contrast, pre-existing foundations have been given from 15 to 25 years to reduce their excess holdings.

A donor informed of these rules can only conclude that Congress did not want him to create a foundation. But let us suppose he persists in his desire. One must then explain to him the other private foundation rules. The prohibitions against self-dealing and jeopardy investments are not likely to be further deterrents, nor are the expenditures responsibility requirements. Rather, the provisions that will concern him are the 4% tax and the pay-out rules. The most common reaction to the 4% tax is one of disbelief, upsetting as it does the long-standing tradition of tax exemption for charitable activities. The fact that it is labeled an "excise" and not an income tax and is for "audit" purposes does not make a difference. He will view it as a diversion to government of funds he intended for philanthropy.

In regard to the pay-out rules, a donor who is a knowledgeable investor will recognize that to use one year as a base (and that an atypical one), does not make economic sense, nor does it permit prudent investment, particularly in times of economic recession. These objections to the pay-out rule as it is currently constituted are applicable to all foundations new or old. A person contemplating a gift to a new foundation will also be concerned with whether the combination of a high pay-out rate and the prospect of continuing inflation will permit any foundation to have an effective role in the future. A further difficulty is that the pay-out rule is imposed at once: there is no transition period similar to that permitted for pre-1969 foundations. The new foundation thus has inadequate time to establish programs or plan a meaningful investment policy. The absence of a transition period for new foundations (and for major capital gifts to existing ones) poses even more serious problems when the donated assets are corporate control stock and often will be the decisive factor in a determination not to proceed.

My own experience since passage of the Tax Reform Act confirms these reactions of hypothetical donors. Although I have seen the termination of many private foundations, large and small, I have been involved in the creation of only two new foundations since 1969. In each case they were established with token assets during the life of individuals desirous of assuring an estate tax deduction for a major testamentary gift. However, in both instances, upon receipt of the bequest the foundation will be eligible to terminate its private foundation status; in one instance because it will be operating a community center receiving public support, in the other because it will then be supervised and controlled by publicly supported charities. In other words, neither organization was intended, even from the date of creation, to be a foundation in the accepted sense of the word. Needless to say, this is in striking contrast to my experience before the Tax Reform Act.

I referred to the fact that I have participated in a large number of terminations of private foundations. The reasons for these terminations were not identical. However, they all reflected a reaction to the complexities of the Tax Reform Act, a desire to avoid the 4% tax, and the additional administrative expenses necessary to operate under the new rules. If the creator of the foundation was still alive, his inability to make major gifts of appreciated property for the rest of his life was a major factor. It should also be recognized that in many instances where a private foundation has been terminated, the principal donor has at the same time revoked a testamentary gift, often a large one, to that foundation. Thus, the "birth rate" of foundations cannot be dissociated from the question of termination.

I have been describing reasons for terminations that have already been accomplished. It is now evident, however, that many foundation managers who had deferred a decision to terminate until they had more experience under the new rules now feel that the economic situation requires them to reconsider. There can be little doubt that continued economic recession will cause the rate of terminations to increase.

The inescapable conclusion from the foregoing is that, despite statements to the contrary, Congress in 1969 acted effectively to block the continued presence of foundations as a major component of private philanthropy. In Professor John Simon's statement to the Sub-Committee a year ago he succinctly described the unhealthy impact a diminished number of foundations will have on the entire field of charity:

"(a) There are only about 350 foundations in the \$10 million-and-over class—i.e., with enough resources to be major sources of financing for new ideas and approaches.

(b) Only one or a handful of these 350 foundations may operate in a given field of work (e.g., mental health, pollution control) or in a given geographical sector. Accordingly, persons and groups seeking funds for new programs often have very few doors on which to knock.

(c) A declining rate of entry into the foundation field will further reduce the already limited options available to those who seek financing and, at the same time, will leave the remaining foundations in a particular field of work or a particular region with an undesirable degree of power to determine the rate and form of social and scientific innovation."<sup>1</sup>

In the eyes of a society that has depended upon and benefited from the unique contributions of private philanthropy, this altered role for foundations represents a major policy change. I find no evidence that it was carefully considered by the Congress, yet I am not convinced that it would be acceptable to a public that was fully aware of its ramifications. The Sub-Committee is to be commended for its current attention to these questions and it is earnestly hoped that it will recommend amendment of at least some of the provisions which I have described as disincentives.

Senator HARTKE. Our next witness we will hear will be Mr. John Ryan, president of Indiana University, who is here today representing the American Council on Education.

**STATEMENT OF JOHN RYAN, PRESIDENT, INDIANA UNIVERSITY,  
REPRESENTING THE AMERICAN COUNCIL ON EDUCATION;  
ACCOMPANIED BY JOHN MORSE, DIRECTOR, OFFICE OF GOVERN-  
MENT RELATIONS, AMERICAN COUNCIL ON EDUCATION**

Mr. RYAN. Mr. Chairman, I am John Ryan, President of Indiana University. I feel privileged to be invited to appear before this committee this morning, and I appear on behalf of the American Council on Education, which is an association of 1,587 colleges, universities, and higher education associations.

I am accompanied by Mr. John Morse, who is director of the Council's Office of Government Relations.

I have submitted a written statement earlier, Senator, and I think perhaps you have some time problems, so I therefore would not read this statement in its entirety, but there are some points I would like to go through.

Senator HARTKE. Fine, you summarize it. That will be fine.

Mr. RYAN. Thank you.

Today, higher education in the United States is an enterprise of more than \$30 billion. The latest reliable figures we have are from 1972-73, and in that year expenditures of our colleges and universities reached the \$28½-billion level. According to the Council for Financial Aid to Education, in that year charitable contributions to those institutions totaled \$2.24 billion, almost 10 percent of their entire support. To give you some feel for the importance of that figure please let me point out that from the Federal Government, support to those institutions amounts to 15 percent—almost 10 percent from the charitable institutions, 15 percent from the Federal Government.

Furthermore, the Federal share was and is, for the most part, targeted on needed services identified by the Government, while chari-

<sup>1</sup> Statement of John G. Simon, in United States Senate, Committee on Finance, Hearing before Subcommittee on Foundations, 93 Cong., 1st Sess., p. 173.



table support is, for the most part, available to other needs defined by the institutions themselves. I do not want to imply, and do not imply, that one is more important than the other because both are absolutely essential to colleges and to universities in carrying out their functions. But they are different, and so even if it were in the cards for Federal appropriations to increase even to make up for any decline in charitable contributions, a balance, a precious balance, would be lost.

That is why we view with alarm any proposals that are made by some economists that would tamper with or eliminate the charitable contribution deduction from our tax laws on the grounds that it would be a diversion of tax funds, that such deductions are a diversion of tax funds and might better flow to the Treasury and be appropriated by the Congress.

Now how do private foundations fit into all of this. In the same year that I referred to, 1972-73, gifts from private foundations alone accounted for almost 25 percent of all the charitable support for higher education. Another 15 percent of that support came from corporations.

Now it is no secret to you, Mr. Chairman, that higher education institutions and everybody else are in great financial, economic difficulty these days. Let me just recount that in the mid-1960's, not 10 years ago, Federal support accounted for over one-fifth of the revenues to higher education, 22 percent. Today, it accounts for 15 percent. College endowment funds are suffering the same erosion that foundations are experiencing in their own portfolios. The concept of investing for total return, rather than for income, seems to have worked well in times of rising markets, but is disastrous in times like these.

Many of our costs are increasing as they are for every family in the United States. We have cut costs; we have reduced programs; we nip and tuck here. I would say that the need for these moves has increased as Federal support has declined, and even these avenues are being closed. A year ago the analyses upon which virtually all student aid programs, including Federal programs like the basic opportunity grants, are based suggested that the average two-child, \$12,000. per year family could provide \$1,260 toward the cost of educating one child in college. Recent adjustments made in the light of the increased cost of living indicate that next year that same family can provide only \$460.

I would also like to point out that it is widespread and it is mistaken that somehow charitable giving only to private higher education. The fact is that in 1971-72, 22 percent of all such gifts, charitable gifts, went to public institutions, and I believe that percentage has risen since that year.

Let me tell you in a few words what foundation support has meant to my own university, Indiana University. In 1973 Indiana University received charitable gifts from individuals and foundations in excess of \$13 million. These gifts are very important to the University. They provide largely the student financial aid and funds for special and auxiliary programs, which are necessary aids to the academic curricula of the institution.

Included in that 1973 total of \$13 million was slightly over \$1 million from foundations. In addition to the \$13 million during the same period, in addition to that, approximately \$2 million in highly specialized research grants was received from foundations. This supple-

ments research funds available through Federal agencies and provides research monies for projects and disciplines not usually supported through other sources.

It is extremely important for Indiana University to be able to depend on these diverse sources of funds. This is especially true today when money for new and innovative programs is increasingly difficult to find, and there are pressures to keep costs incurred by students at as low a rate as possible. Indeed, such funds provide not only the margin necessary for programs and students aid not covered by other sources but in doing so provide what has been called the margin of excellence necessary for great institutions.

Mr. Chairman, let me close by making two comments. In 1969 in testimony before the Ways and Means Committee and the Senate Finance Committee, the American Council on Education urged that Congress levy a fee on foundations sufficient to underwrite the cost of the Internal Revenue Service audits, but that it not impose a tax. Our view was then and is now that a tax on foundations is not really a tax on them but on the public charities that they support, and we would like to renew that plea that there be a fee and not a tax—and I might say parenthetically, Mr. Chairman, I commend your own statement on that point.

Second, we would urge that Congress review the many factors that inhibit the growth of existing foundations and the establishment of new ones. Here we are concerned not only with the so-called private foundations—and we are concerned with them—but also with those established by corporations. As I have said, corporate support is an important source of funds for higher education and potentially an increasing one, but that support is bound to rise and fall as year end balance sheets change. Corporate foundations that can even out the good and the bad years have provided a degree of stability in corporate giving, yet it is our impression that following the 1969 Act, few new corporate foundations are being formed, and many that have existed are being liquidated. That is our impression.

We hope that the testimony during these hearings may shed further light on this particular phenomenon and enable you to take any corrective action.

Thank you, Mr. Chairman, for your interest in this matter which I consider to be of great importance in higher education for all of us, and thank you for your patience. I would be pleased to answer any questions you may have, Mr. Chairman.

Senator HARTKE. Two observations which do not necessarily go to your testimony—the Washington Post reports this morning that the President intends to veto the Veterans Aid bill, which deals with higher education, as being inflationary. I would point out that it increases the amount for a single veteran who has gone off to Vietnam in the jungle from \$1,980 a year to \$2,430 a year.

If I am not mistaken, even at Indiana University, is the fee not about \$700 roughly?

Mr. RYAN. Yes, sir.

Senator HARTKE. That means that he has about \$1,700 to live on, buy his books—

Mr. RYAN. About \$1,700 he would have after paying just the fees. It may not be on the point, Senator, but I would like to commend you for

your own personal interest in improving benefits for veterans who attend school, particularly colleges and universities and particularly Indiana University, and let me say that my personal experience in Indiana is that the last half-dozen years, we have seen that the veterans who are entitled to educational benefits have not been using them, and I think the reason is they have not had sufficient support.

I am not an economist; I do not know what the pro and con inflation effects would be of providing this veteran support, but I really cannot believe that the place to fight inflation, to begin the fight for inflation, is with veterans' benefits.

Senator HARTKE. Let me say that, of course, you know, I have a deep feeling of gratitude for the fine work that Indiana University was able to do for me at law school. I was there twice; it took me a long time to get out of law school, starting in 1941, not getting out until 1948, but the first time that I started out there, I might say that I was a recipient of financial assistance, receiving two scholarships, which frankly, permitted me to go to school.

Of course, after I came back, I went back on the GI bill, so I have had both experiences.

Let me ask you, is it true that from your general overall statement that the governmental support of higher education today is declining?

Mr. RYAN. The Federal Government support now is an element in the overall expenditures of colleges and universities. Well, let me not make so broad a statement. In terms of universities of the Indiana University type, I know that—it may well be true of colleges and universities in general—Federal support funds make up a smaller relative proportion of our expenditures today than they did as recently as 5 or 6 years ago, and there is some very helpful statistical information on this.

I am sorry, I do not have it at my immediate command, but contained in the report of the Commission, of which Congressman Brademas was a member—I know that because that is how I got a copy of the report of the Commission—there is some very helpful information in there, but it indicates clearly that the Federal Government's level of support as a proportion of our expenditures is less today than a few years ago.

Senator HARTKE. Would a decline in charitable contributions and a decline in private giving affect the governmental support that the institution has, in your opinion?

Mr. RYAN. I would not say a direct effect, Senator. In other words, I would not think that we could expect Federal support to increase as a reaction to a decline in support from foundations, public or private foundations.

Second, I would say though—and I think I did say in the statement—even if this were to be true, we would lose the advantage, whether the advantage of the balance of having support funds for the kinds of activities that institutions place priority on and perhaps the Government does not if we were to depend more on Federal funds or public funds.

Senator HARTKE. I suppose that you have the same general erosion in your assets and endowments as is being experienced by the foundations, is that true?

Mr. RYAN. Well, of course, there is a wide range of foundation experience. I do not think we did quite as well as the Lilly endowment did,

as I heard this morning, the Lilly endowment did, but we have not done as poorly as the Ford Foundation apparently did.

The Indiana University foundations' portfolio experience this past year has been one of loss. I would guess that it would be on the order of 18 percent, something like that, in the market value of the securities.

Senator HARTKE. All right. I thank you.

Mr. RYAN. Thank you, sir.

[The prepared statement of Mr. Ryan follows:]

PREPARED TESTIMONY OF PRESIDENT JOHN RYAN, INDIANA UNIVERSITY,  
REPRESENTING THE AMERICAN COUNCIL ON EDUCATION

Mr. Chairman and Members of the Subcommittee, I am John Ryan, president of Indiana University, and am appearing this morning on behalf of the American Council on Education, an association of 1,587 colleges, universities and higher education associations. I am accompanied by John Morse, director of the Council's Office of Governmental Relations.

At the outset, Mr. Chairman, may I express our gratitude to you on two counts: first, for your interest in and concern about the impact that inflation and the declining value of investment portfolios is having on foundations and their ability to sustain past levels of support to a variety of charitable enterprises; and second, for giving us an opportunity to meet with you and examine this phenomenon from the point of view of higher education.

Higher education in the United States is today a \$30+ billion enterprise, but the latest reliable figures we have are for 1972-73. In that year total expenditures of colleges and universities reached a level of \$28.5 billion. According to the Council for Financial Aid to Education in that year charitable contributions to those institutions totaled \$2.24 billion—almost 10 percent of their entire support. To give you some feel for the importance of that figure it might be well to point out that support from the Federal Government from all agencies and for all purposes, including research, amounted to only 15 percent. Furthermore, the Federal share was and is for the most part targeted on needs and services identified by the government, while charitable support is for the most part available to meet needs defined by the institutions themselves. I do not for one moment imply that the one is more important than the other. Both are absolutely essential. But they are different, and so, even if it were in the cards for Federal appropriations to increase and make up for any decline in charitable contributions, a precious balance would be lost. That is why we view with great alarm proposals being made by some economists that would tamper with or even eliminate the charitable contribution deduction from our tax laws, on the grounds that it is a diversion of tax funds that might better flow to the Treasury and be appropriated by the Congress.

How do the private foundations fit into all this? In the same year about which we have been speaking—1972-73—gifts from that source alone accounted for almost 25 percent of all charitable support of higher education. Another 15 percent came from corporations, and I should like to return to that topic in a moment.

We are now in an era when higher education is caught in cross currents from so many different directions that even the most optimistic skippers wonder how we are to keep the ship afloat. In the mid-1960's Federal support accounted for 22 percent of higher education's revenues; it is now, as I have indicated, down to 15 percent. College endowment funds are suffering the same erosion that foundations are experiencing in their portfolios. The concept of investing for total return rather than simply for income is brilliant in times of rising markets, but disastrous in times like these. The cost of energy alone, a significant item in every college budget, has gone up as much as 300 percent in the last year. Faced with these facts, colleges, public and private alike, have responded in the only two ways available to them—by cutting costs to the bone and even into the marrow and by passing on a larger share of the costs to the consumer, the student and his parents, in the form of higher tuition and fees. The need for these moves has increased as Federal support has declined, but even these avenues are being closed. A year ago the analyses upon which virtually all student aid programs, including Federal programs like the basic opportunity grants, are

based suggested that the average two-child \$12,000 per year family could provide \$1,260 toward the cost of educating one child in college. Recent adjustments made in the light of increased cost of living indicate that next year that same family can be expected to provide only \$460.

I hope that this recital will seem to you relevant to the subject of these hearings, for the point is that higher education must rely heavily on diverse sources of support, and the foundations are one such essential source. Any reduction in their ability to sustain or even increase their share puts even greater strain on other sources at a time when they too are forced into retrenchment.

There is a widespread and mistaken view that somehow charitable giving is important only to private higher education. The fact is that in 1971-72, 22 percent of all such gifts went to public institutions and that percentage has, I believe, risen since. Let me tell you what foundation support has meant to my own university.

In 1973 Indiana University received charitable gifts from individuals and foundations in excess of \$13 million. These gifts are very important to the University, providing largely student financial aid and funds for special and auxiliary programs which are necessary aid to the academic curriculum.

Included in the 1973 gift total was slightly over \$1 million from foundations. In addition to the \$13 million during the same period, approximately \$2 million in highly specialized research grants was received from foundations. This supplements research funds available through Federal agencies and provides research money for projects in disciplines not usually supported through other sources.

It is extremely important for Indiana University to be able to depend on these diverse sources of funds. This is especially true today when money for new and innovative programs is increasingly difficult to find and there are pressures to keep costs incurred by students at a low affordable rate. Indeed, such funds provide not only the margin necessary for programs and student aid not covered by other sources but in doing so provide what has been called "margin of excellence" so necessary for great institutions.

Let me close by making two comments. In 1969 in testimony before both the Ways and Means Committee and the Senate Finance Committee, the American Council on Education urged that Congress levy a fee on foundations sufficient to underwrite the cost of IRS audits, but that it not impose a tax. Our view was then and is now that a tax on foundations is not really a tax on them but on the public charities that they support. We would like to renew that plea.

Second, we would urge that Congress review the many factors that inhibit the growth of existing foundations and the establishment of new ones. Here we are concerned not only with the so-called private foundations, but also those established by corporations. As I have said, corporate support is an important source of funds for higher education and potentially an increasing one, but that support is bound to rise and fall sharply in the light of year and balance sheets. Corporate foundations that can even out the good and bad years have provided a degree of stability in corporate giving. Yet, it is our impression that because of the 1969 act, few new corporate foundations are being formed and many that have existed are being liquidated. We hope that testimony during these hearings may shed further light on this phenomenon.

Thank you, Mr. Chairman, for your patience. We shall be glad to answer any questions.

Senator HARTKE. I am going to recess here for just about 3 or 4 minutes, and we will proceed with the other witnesses.

[A brief recess was taken.]

Senator HARTKE. The committee will please come to order.

Prof. C. Lowell Harris? The next witness will be Prof. C. Lowell Harris of Columbia University. Is he here?

All right. The next witness, then, will be Thaddeus Seymour, president of Wabash College in Crawfordsville, Ind., appearing here on behalf of the Associated Colleges of the Midwest and the Great Lakes College Association.

**STATEMENT OF THADDEUS SEYMOUR, PRESIDENT, WABASH COLLEGE, ON BEHALF OF THE ASSOCIATED COLLEGES OF THE MIDWEST AND THE GREAT LAKES COLLEGES ASSOCIATION**

Mr. SEYMOUR. Good morning, Mr. Chairman.

Senator HARTKE. I am glad to see all of these Indiana people here, because it demonstrates that all the talent comes from Indiana, or eventually ends up there.

Mr. SEYMOUR. I am glad to be here with the Indiana delegation, as represented on both sides of the table.

Mr. Chairman, my name is Thaddeus Seymour. I am president of Wabash College, which is, as you know, a small independent liberal arts college for men in Crawfordsville, Ind. I am chairman this year of the Great Lakes Colleges Association, which is a consortium of 12 such independent colleges in Indiana, Ohio, and Michigan, and I come before this subcommittee today on behalf of both the Great Lakes Colleges Association and the Associated Colleges of the Midwest, which is a similar consortium of 12 colleges in the Midwestern States. For the rest of our organization, on behalf of all of them, I would like to express appreciation to this subcommittee for the opportunity to appear, and second, a keen interest—indeed, a self-interest—in the topic which is before you.

My statement on behalf of our colleges is on file, and it represents a more systematic approach to the question at hand, and contains an appendix of information which we hope will be helpful to this committee as it reviews and considers. Obviously, we would be pleased to provide additional information, if that would be helpful to you. Since a written statement is already in your hands, I would like very briefly to comment on the main points of that presentation, with particular emphasis on the role of foundations in providing leadership and incentives as they encourage colleges to solve their own problems. And in this regard, and perhaps pursuant to your questions of Landrum Bolling, I would like to emphasize, from the colleges' point of view, our sense of the role and the value of private foundations to education in a free society.

My statement stresses the obvious, which is that colleges are in financial trouble. We need to use the word "squeeze," and we are now using the word "crunch." Costs go up; we try to meet them with increased tuition. This in turn has an adverse effect on our enrollment and requires a greater demand for financial aid. The colleges have serious financial problems, which we are taking seriously.

We have four sources to meet our financial needs. The first I have alluded to already, which is tuition. But our problem is to meet the gap which grows and widens between tuition and operating expense. We do some of that with our endowment, but, as others have already commented, the current financial situation has had an adverse effect on our own endowment income.

We meet our expenses also by State and Federal grants, but we read with concern about cutbacks in these programs. Finally, and most appropriately, we depend on gifts from the private sector. Personal gifts are hard hit by a recession, but it is of foundation support that we speak today.

Foundations represent for our colleges 10 percent of our annual support. When I make a comment about percentage points, I suspect the greatest revolution for a new college president is to discover the true importance of a percentage point. Most of us, who grew up as young faculty members, never took percentages very seriously as we looked at percentage rates on installment loans or retirement plans or fringe benefits or even class enrollment. Well, I want to underscore the fact that, for us, 10 percent of our budget, when we suddenly find ourselves looking at a budget of \$5 million, is something quite different. Foundation support, as part of our operating budget, is terribly important to us just in terms of dollars.

Well, what I want to stress to this committee is that the role of foundations for us goes far beyond dollars. You yourself have said, Senator Hartke, that the role of foundations should be the cutting edge of innovation and experimentation, and they do in fact play an important role of that sort for us in higher education. Foundations today, it seems to all of us, have—and appropriately—have shifted their priorities to be as responsive as they possibly can to our needs, to help us help ourselves. So foundations are encouraging our inquiry and experimentation into such areas as admissions procedures and policies, the ability of students to pay their own way in college, challenges which will encourage new sources of voluntary gifts to colleges, new techniques for financial aid, new approaches to career education, to the management of our affairs, to ways to develop a strategy so that we can replace capital investments with current funds, important new programs in faculty development, and so on.

Perhaps the most direct answer to your question of Landrum Bolling, at least from the point of view of higher education, is that foundations play a very important part in our lives. They challenge us to address our own questions, our own problems, and encourage us that they will help us solve them. I cannot stress enough that on the Wabash campus, as an example I know the best, we are looking with greater sense of confidence at the possible solution to problems, because we know if we can begin to see a glimmer of a response, we can go to a foundation which will give us at least the startup money to try. I think the vitality that foundations represent as they encourage colleges to move in this direction is terribly important to us.

In that regard, Mr. Chairman, I would like to leave with your subcommittee an editorial<sup>1</sup> which appeared in the November issue of *Change* magazine, written by the editor, George Bonham, which speaks about the crisis in philanthropy, and addresses among other things the questions I have just commented on.

Finally, Mr. Chairman, I simply want to say that on behalf of the colleges whom I am representing today, we take our stand with the foundations. We encourage whatever efforts can be made to provide relief for them. Again, echoing what Landrum Bolling said earlier, we urge assistance not simply for the short-term need but the long-term welfare because the future of independent higher education, indeed all higher education, is inextricably linked with the future welfare of foundations in our judgment. Thank you.

<sup>1</sup> See page 232.

Senator HARTKE. Mr. Seymour, let me ask you, as I did Mr. Howe yesterday; do you foresee the demise of private colleges in this country?

Mr. SEYMOUR. Certainly not the demise of the private colleges. But I think a number of so-called invisible colleges are in very serious trouble now, or are in the process of closing their doors.

Senator HARTKE. Do you think they are worth saving?

Mr. SEYMOUR. Yes. I have sat as a member of the evaluation team for the North Central Association. I have been a commissioner in that group for a number of year, and twice each year, we meet to review the performance of, I would have to say many, colleges I have never heard of before. And yet, in each instance, as I see the commitment of the people who represent those institutions and understand the quality of service they are performing, usually to students in their own region, I am convinced they perform a very real service. They represent not only immediate service to their community, but they also reflect the kind of diversity which has been spoken of before and is terribly important to us as a society.

Senator HARTKE. In the field of innovation and change, do you intend, or is what you are saying in your statement in essence contending that the help of foundations has been a particular factor in that area?

Mr. SEYMOUR. It has been a major factor in that area in two ways. Foundations are saying to colleges like ours, we know you are wrestling with this tenure problem, which is a very serious problem, the whole question of the vitality and mobility of faculty in our institutions. If you think you are coming close to an answer, come talk to us about the possibility of our giving you some funds to address that problem. We can sit around under a tree and speculate on solutions, but unless we have some hope of having some dollars to support them, we will probably divert our thoughts to other things. The spillover effect for each institution, of specific projects that are funded elsewhere is also terribly important to us. As this foundation studies financial aid and that foundation studies faculty policies, the reports of those studies are helpful to each of us.

Senator HARTKE. What amount the disadvantaged students, or those who are unable to pay their own tuition? Are the foundations a major factor there?

Mr. SEYMOUR. The foundations are playing a less important role in that kind of direct scholarship aid, which is frankly, and I think quite properly, increasingly a role of State and Federal Government, particularly as scholarship dollars go to the student and give him freedom of choice to attend the institution that he prefers. I think it is one of the particularly appropriate ways for Government funds to support higher education.

Senator HARTKE. I need some help to explain one of your charts in one of your appendixes. It is appendix B-1. This is a chart which indicates private foundation Federal support to the Associated Colleges of the Midwest from 1958 to 1974. Am I right that since 1969, there have been, for all intents and purposes, an absolute drying up? Is that what this chart shows?

Mr. SEYMOUR. The chart does reflect the fact that foundation support to the Associated Colleges of the Midwest has—



Senator HARTKE. According to this, I would gather it was \$5 million in 1970—is that right? I think that is what the chart shows, and it shows zero in 1971.

Mr. SEYMOUR. I should make it clear that this does not cover foundation support in the form of scholarship assistance to students. These represent Government grants, National Science Foundation grants, and so on.

Senator HARTKE. I know. But my reading of the chart was that the shaded area was private foundation support.

Mr. SEYMOUR. That is correct.

Senator HARTKE. And it shows that in 1970, it would be \$5 million, in 1971 to be zero, 1972 \$40 million, 1973—

Mr. SEYMOUR. Well, those are literally \$40,000, not \$40 million; we are dealing with a much smaller series of numbers than one would expect.

Mr. Chairman, what I would like to—

Senator HARTKE. Well, go ahead.

Mr. SEYMOUR. What I would like to provide, in order to clarify—I do apologize that the bar graph does not give the detail that it should—is the detail of specific grants to this consortium, not to its member colleges which I can make available to the committee. I do not have it with me.

Senator HARTKE. Fine. That would be helpful for the committee.

All right. We are going to recess now until 1 o'clock for the rest of you. All right?

[A brief recess was taken.]

[The prepared statement and material subsequently supplied by Mr. Seymour follow:]

PREPARED STATEMENT OF DR. THADDEUS SEYMOUR, PRESIDENT,  
WABASH COLLEGE, CRAWFORDSVILLE, IND.

Associated Colleges of the Midwest		Great Lakes Colleges Association	
Beloit	Knox	Albion	Hope
Carleton	Lawrence	Antioch	Kalamazoo
Coe	Macalester	College of Wooster	Kenyon
Colorado College	Monmouth	Denison	Oberlin
Cornell (Iowa)	Ripon	DePauw	Ohio Wesleyan
Grinnell	St. Olaf	Earlham	Wabash

Mr. Chairman and members of the subcommittee: As President of a small college in Indiana and the appointed spokesman for two consortia representing twenty-four such institutions in the Midwestern states,<sup>1</sup> I presume to present myself to this Subcommittee on behalf of all the small, private, undergraduate, liberal arts colleges across the land. We are a burdened and beleaguered lot right now, trying to cope with rising costs and declining enrollments. It is therefore with appreciation that we take this opportunity to bring our cause to this Subcommittee of the Senate and petition on behalf of the philanthropic foundations whose affairs you oversee.

As this Subcommittee considers the impact of current economic conditions, we urgently recommend adoption of policies which will encourage voluntary philanthropy. Independent education in America has been sustained by volunteer finan-

<sup>1</sup> The Associated Colleges of the Midwest: Beloit, Carleton, Coe, Colorado College, Cornell (Iowa), Grinnell, Lawrence, Knox, Macalester, Monmouth, Ripon and St. Olaf.  
The Great Lakes Colleges Association: Albion, Antioch, Denison, DePauw, Earlham, Hope, Kalamazoo, Kenyon, Oberlin, Ohio Wesleyan, Wabash and Wooster.

cial support throughout its history. Private foundations are a particularly important source of support.

### I. ECONOMIC PRESSURES ON HIGHER EDUCATION

Dramatic accounts of the financial plight of small colleges are commonplace. A new lexicon has been developed to describe these "invisible colleges" which are in the "crunch" as the "baby boom" enrollments give way to "drop-outs" and "stop-outs." *Forbes Magazine* put it bluntly in its September, 1974, issue: "Many of our colleges and universities are going broke."

The summary of economic pressures is a familiar one. In two decades expenditures for higher education have increased ten-fold, from \$3.5 billion to \$35 billion, but income has steadily fallen behind expense. There is nothing esoteric about the arithmetic of bankruptcy, wherever it occurs . . . cost goes up and income goes down. Every commentator on higher education has figures to document the widening gap between expense and income. William Jellema has chronicled the finances of colleges in a number of studies. In one he performs a calculation which demonstrates that in ten years 365 of the 762 private, accredited four-year colleges and universities will "be running deficits equaling or exceeding their liquid assets."<sup>1</sup> This analysis was based on 1971 projections, before double digit inflation.

Although I cannot seriously believe that conditions are *that* desperate, I have first-hand knowledge, as all college presidents do, that we have entered a stage where financial problems have moved from "serious" to "critical." To meet the rising cost of education, colleges have raised tuition fees substantially—36 percent in the last four years; 9.4 percent in the past year alone. High tuition fees discourage enrollment and create a greater demand for financial aid. Inflation simply makes matters worse. The falling market has affected our endowments: book value is sometimes as much as a third lower now than two years ago. Donors tell us they are deferring gifts until the market improves. Furthermore, we understand that support of education and research will be cut back significantly in the new Federal budget Congress will consider for the next fiscal year.

In short, as financial pressures affect tuition income, colleges must turn to other sources of funds to "fill the gap." It is therefore alarming to consider any reduction or limitation in the capacity of philanthropic foundations to support higher education.

### II. DOLLAR SUPPORT BY FOUNDATIONS

Voluntary philanthropy is fundamental to the independence and diversity of American higher education. The spirit of service and voluntarism which created our educational system is sustained by the tradition and legislation which encourages private contributions. Private colleges and universities meet their expenses from four sources: (1) Tuition and fees; (2) endowment income; (3) State and Federal grants; and (4) Private gifts and grants. It is obvious that current economic conditions have had an impact on each of these categories.

The 5,500 private foundations listed in the *Foundation Directory* allocate nearly 50 percent of their grants to higher education. The total has been estimated at more than \$1 billion for last year. This represents 10 percent of our respective operating budgets, a significant contribution to annual operating costs. For the decade 1959-1969, the twelve colleges and the central office of the Great Lakes Colleges Association received more than \$42 million in foundation grants, almost exactly 10 percent of the \$432 million received from all sources. (See Appendix A.)

Colleges recognize fully the necessity to reduce their operating costs. Important and effective steps are being taken on all of our campuses, as institutions impose on themselves the discipline of better planning and management. However, no matter how straitened the budget and lean the operation, philanthropic support will always be essential.

As higher education looks to the future, the need for foundation support is greater than ever.

### III. FOUNDATION LEADERSHIP AND INCENTIVES

Foundations provide more than dollars in their support of higher education. As our pluralistic system encourages diversity among the 5,500 foundations, all

<sup>1</sup> William W. Jellema, *From Red to Black?* (San Francisco: Jossey-Bass, 1978), p. 24.

institutions benefit from the range of their interests and activities. In supporting the efforts of colleges to solve their current financial problems, foundations are providing just the sort of leadership encouraged by Senator Hartke in his statement before this Subcommittee last May: "I believe that foundations should be the cutting edge of innovation and experimentation, that they should be probing the resources of America so that we can raise the quality of life for all Americans."

The two consortia of colleges I speak for today originated by way of generous Ford Foundation grants in 1958 and 1962. A few years later consortium arrangements became a high priority for qualifying for certain Federal funds. But the principle of cooperation among institutions for efficiency of operations, sharing of resources and experimentation in educational programs began with foundation grants. Both consortia continue to depend on foundation grants for many of their innovative programs. (See Appendix B.)

The Associated Colleges of the Midwest-Newberry Library Seminar in the Humanities brings students from their undergraduate campuses to study and conduct research among the splendid collections of the Newberry Library in Chicago. This program was first underwritten by the Carnegie Foundation in 1964, several years before Congress authorized the National Endowment for the Humanities. The government agency did match aid with the Avalon Foundation (now the Andrew W. Mellon Foundation) for a later grant to the program.

The instances of combined foundation and Federal grants have enabled our colleges to bring about significant changes. Dean Bruce Morgan of Carleton College says, "The Alfred P. Sloan Foundation grant to science at Carleton revolutionized our science program. That grant followed by the National Science Foundation College Science Improvement Program grant clearly lifted our sciences to a level of excellence they had not previously attained." The grants provided curriculum change, faculty renewal and stimulation of faculty research, equipment and new science courses for non-science majors.

A case of a Federal grant spurring foundation support is the U.S. Office of Education Special Services grant to Macalester College, which enabled the college to develop its minorities program. As a direct result Macalester has developed a three-year program to serve American Indians, which has attracted a Rockefeller Foundation grant.

Some foundations fund areas of special interest. One foundation particularly supports efforts to improve management; another encourages innovative approaches for programs of financial aid and admissions; another provides incentives for increased alumni and corporate giving. The ACM and GLCA colleges have received foundation grants in each of these areas with the result that innovative and experimental programs have been developed.

Coe College, for instance, has benefited from two Louis W. and Maud Hill Family Foundation grants to improve admissions and academic productivity, a Danforth Foundation grant to develop teaching paraprofessionals, and a Ford Foundation Venture Grant for academic innovation. Denison University is introducing simulation programs into the curriculum by virtue of a Lilly Endowment grant. Grants from the Andrew W. Mellon Foundation and the R. K. Mellon Foundation to Denison have provided faculty support improvement in faculty salaries. Three grants from the Kresge Foundation have aided construction of two Denison buildings and renovation of a third. Colorado College effected its striking "Colorado College Plan" enabling students to study one subject at a time in variable-length calendar segments with the help of a Ford Foundation grant. St. Olaf College coined the word "paracollege" and instituted an experimental college-within-a-college by way of a Louis W. and Maud Hill Family Foundation grant.

Foundations are encouraging higher education to find solutions to the more strategic issues of educational purpose, personnel policy including tenure, and teaching effectiveness. The colleges in our group are currently receiving foundation support in these areas and have already undertaken important new programs in career education, faculty development, and innovative teaching. The Allegheny Foundation has assisted Ohio Wesleyan University's successful Institute of Practical Politics. DePauw University has received Lilly Endowment support for a program of training for careers in business and public service.

The dollar grants of private foundations are extremely important to higher education, but equally important is the *nature* of this support. Consider the Research Corporation's aid to scientists at undergraduate colleges through its

**Cottrell College Science Grants.** These competitive grants are the only source of funding dedicated to research in private, undergraduate colleges *per se*. The National Science Foundation at one time supported considerable research at small institutions, and does yet to a limited degree, but with cutbacks in other forms of federal support for basic research NSF has tried to maximize its effectiveness by emphasizing research at the major universities. During a recent two-year period scientists at seven ACM and GLCA colleges received fourteen grants totalling \$257,949 from the National Science Foundation. In a similar two-year period, scientists at sixteen of our colleges received thirty-one Cottrell Grants for a total of \$351,237. (See Appendix C.) Robert A. Reitz, a professor of physics at Carleton College, explains the value of the Cottrell Grants this way: "Why should research be done at small colleges? There is no doubt in my mind that research keeps a faculty member abreast of some facet of his field and allows for a kind of innovation and creativity which teaching alone simply cannot bring. Further, active research tends to set a tone at an institution, with numerous positive effects on other students not directly involved in the research." The contribution of this one foundation program in "setting the tone" at an institution cannot be measured. We think it may be representative of the special contribution of foundations in upgrading education.

#### IV. RELIEF FOR FOUNDATIONS

This Subcommittee has received many suggestions to provide relief for foundations. The reduction of both the excise tax and the required rate of pay-out seems eminently reasonable in light of recent analysis and experience. However, I speak for grant recipients. We urge that some relief be provided so that foundations will not be forced to reduce their support of higher education. As never before in their history, the independent colleges and universities of America turn to the private philanthropic foundations for support and for leadership.

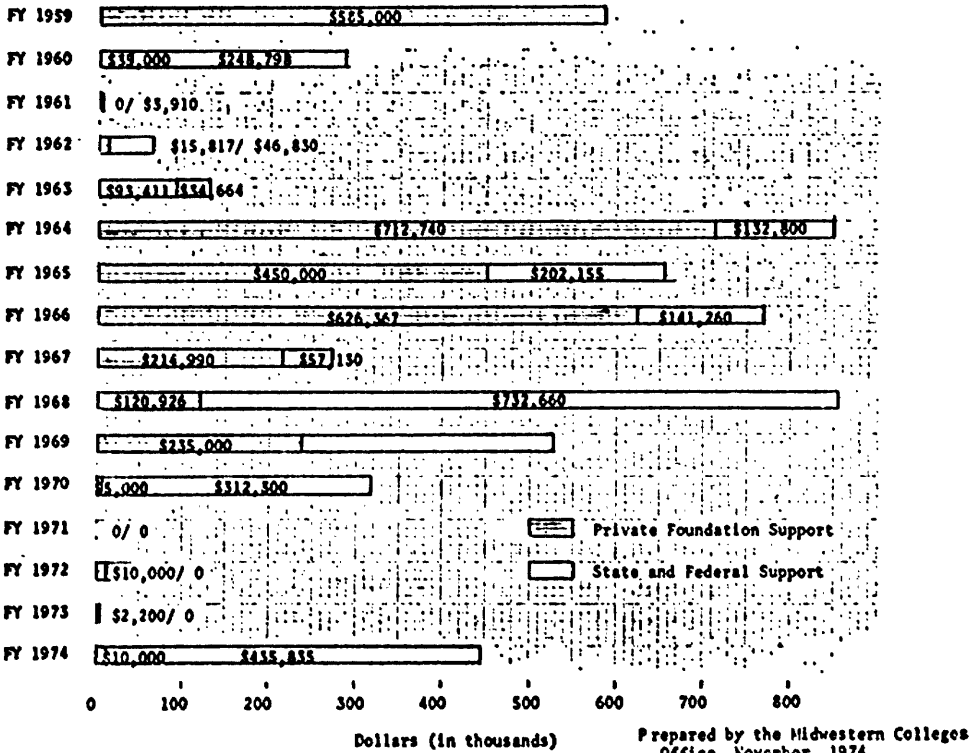
#### *Great Lakes Colleges Association and Member Institutions—Income by source for the period of 1959-1969*

Source of income:	Amount of income
Private foundation gift dollars.....	\$42,330,506
Total value of gift appreciated property.....	38,547,623
Gift value of remainder interest in life income contracts and gifts annuities.....	13,088,000
Total private gifts.....	154,805,132
Total tax supported contribution (exclude State scholarships and loans).....	16,570,131
Total income all sources.....	432,570,833

NOTES.—These figures are the result of an initial examination and are not complete. Certain institutions were not able to respond to each item for all 10 fiscal years.

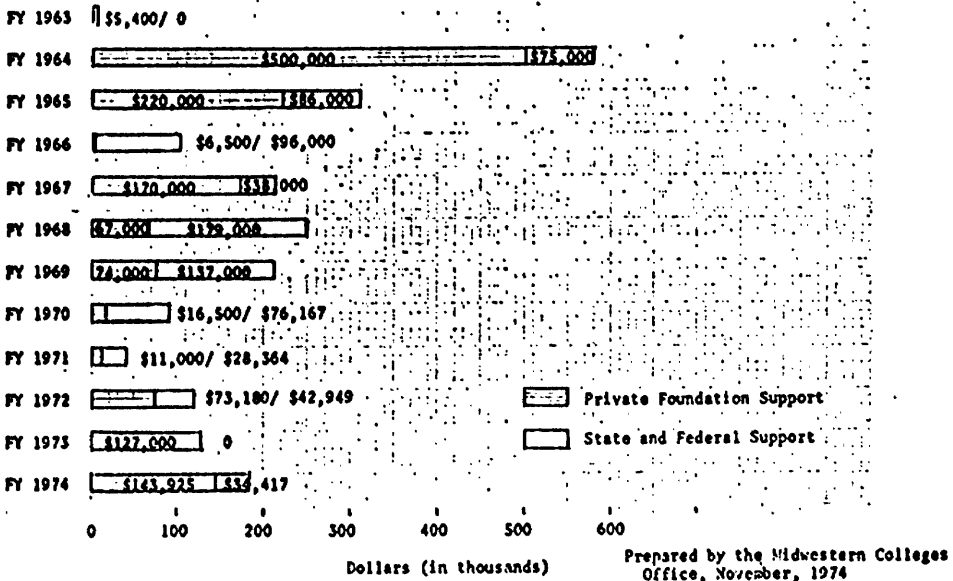
APPENDIX B-1

PRIVATE FOUNDATION AND FEDERAL SUPPORT TO THE ASSOCIATED COLLEGES OF THE MIDWEST, 1958-1974



APPENDIX B-2

PRIVATE FOUNDATION AND FEDERAL SUPPORT TO THE GREAT LAKES COLLEGES ASSOCIATION, 1963-1974



## APPENDIX C

## RESEARCH CORP. AND NATIONAL SCIENCE FOUNDATION RESEARCH GRANTS AT ACM AND GLCA COLLEGES

College	Number of grants	Total dollar amount
<b>Research Corp.:<sup>1</sup></b>		
Beloit.....	1	5,445
Carleton.....	3	30,702
Coe.....	1	8,600
Colorado College.....	1	4,495
Cornell.....	2	28,200
DePauw.....	1	10,900
Earlham.....	1	27,500
Grinnell.....	1	13,000
Hope.....	6	68,285
Kenyon.....	1	6,300
Knox.....	1	7,200
Lawrence.....	2	9,350
Macalester.....	1	4,575
Oberlin.....	4	73,195
St. Olaf.....	2	32,390
Wabash.....	3	31,100
<b>Total.....</b>	<b>31</b>	<b>351,237</b>
<b>National Science Foundation:<sup>2</sup></b>		
Carleton.....	2	10,700
Grinnell.....	1	35,000
Hope.....	5	77,949
Knox.....	1	40,000
Lawrence.....	1	42,000
Oberlin.....	3	42,000
Wabash.....	1	10,300
<b>Total.....</b>	<b>14</b>	<b>257,949</b>

<sup>1</sup> Cottrell College Science Grants, February 1972 to February 1974.

<sup>2</sup> Support for Scientific Research, fiscal year 1972 and 1973.

## GRANTS TO ASSOCIATED COLLEGES OF THE MIDWEST (CENTRAL OFFICE NOT MEMBER COLLEGES)

Date of grant	Source	Use of grant funds	Amount of grant
Jan. 31, 1970	Agency for International Development.....	Central America program.....	\$40,000
May 28, 1970	National Science Foundation.....	do.....	107,400
Do.....	do.....	Argonne semester.....	164,900
Apr. 16, 1973	Japanese Consulate-Chicago.....	Symposium on Japanese-American relations.....	2,200
July 1, 1973	U.S. Office of Education.....	Implementing a regional system for health professional education.....	41,600
Sept. 1, 1973	do.....	Educational development program.....	90,000

[Editorial from Change, November 1974]

## THE CRISIS IN PHILANTHROPY

The recent startling disclosure of the Ford Foundation that it is considering cutting its future grants by half serves only as dramatic confirmation of the fact that American philanthropy is in deep trouble, and with it every educational establishment in the country. The crisis in philanthropy throws into serious question the strong American tradition of private volunteerism, and a major erosion of that tradition can only add burdens to an already heavily laden public tax base.

Ford, the largest philanthropic organization in the country, has for some time dipped more deeply into its capital for grant-giving purposes than most other major foundations, but it has seen its diversified portfolio fall precipitously from \$3.05 billion to \$2 billion in one year. The talk now is not only of sharp cutbacks in its operations, but the possible dissolution of the whole enterprise. The latter is not likely to be considered seriously, but even the suggestion of its possibility gives another jolt to already badly shaken nonprofit enterprises.

While the foundations' plight is serious, it could in fact become precarious. Thus far, however, most other foundations have fared better than Ford, depending on the character of their portfolios and funding practices. Continued

high corporate dividend performance has so far been a saving grace. But profit prospects, too, may be in for rougher sledding in a period of serious stagflation. The assets of the W. K. Kellogg Foundation, for example, have dropped from \$577 million a year ago to \$443 million, while the Lilly Endowment's portfolio (principally made up of Lilly corporate stock) has dropped a relatively low 18 percent. More dramatic downward slides have occurred with other funds, including Edwin Land's Rowland Foundation, whose assets of Polaroid stock have dwindled from last year's high of \$108.2 million to \$15.7 million today.

Foundation officials are also growing increasingly restive over the effects of the 1969 Tax Reform Act provisions, which require pay-out rates equal to net income or a given percentage of total assets, whichever is larger. If incomes slip below the percentage-of-assets provisions, more dipping into precious and diminishing endowments may become the rule rather than the exception. The act's excessive 4 percent excise tax on foundations is additionally burdensome to the degree that the tax has shown to be in considerable excess of the auditing costs of nonprofit organizations, which it was intended to cover: Last year, IRS income from this foundation tax exceeded auditing costs by something like \$35 million, and that was \$35 million less available to the nation's hard-pressed eleemosynary institutions.

All of this, of course, is highly distressing news to the country's colleges and universities, which, as the National Commission on the Financing of Post-secondary Education recently determined, are already in serious financial distress. Indeed, the commission discovered, constant dollar expenditures for higher education stopped increasing during the sixties and began to decline between 1971 and 1973. Close to \$3 billion a year of academic income comes out of gifts as well as endowment income, and both have now been seriously affected. For private institutions, 27 percent of income comes from philanthropic and endowment sources, and the impact of economic slowdown and two-digit inflation is particularly destructive in this area. Despressing Wall Street prices have not only played havoc with foundation portfolios, but also with the endowments of educational institutions and the assets of individual donors, whose generosity is usually circumscribed by performance in the money market and current tax provisions pertaining to gifts and estates. Both have recently come under sharp attack, and both need careful watching by policy makers and educators alike.

The recent vote in the Congress for an emergency \$9-million appropriation to Eisenhower College to stave off bankruptcy only illustrates the very fine line that now separates life and death for a growing roster of colleges. Many of them count on the generosity of one individual, and when pursuits of such potential Mediceis fail, disaster is often close at hand. As individual fortunes change, so may those of a whole college. More typical than one wishes to believe is the case of a high-quality Southern college whose long-term survival largely rests on the fortunes of a single individual who has now seen his paper worth decline by two thirds.

Though the circumstances of a declining economy are particularly onerous for the poorer institutions, even the most well-endowed universities now find themselves the victims of spiraling costs and declining incomes. Not even the Harvards and Stanfords escape this unremitting squeeze, though they have a harder time convincing people, even their own faculties, of the new realities. Stanford's President Richard W. Lyman recently told his academic council that "if revising the operations of a cafeteria whose annual deficit was costing us over \$100,000 of general funds per year is cause for uproar, we're in yorse shape in terms of shared understanding of what we're up against than I, at least, had thought."

It is one of the ironies of current political thought that the traditional characteristic of American society of relying on individual initiative and voluntary action may now be threatened by efforts for federal tax reform, which hopefully will provide a more equitable tax sharing by the wealthy. (See *Change*, Summer 1974, p. 48.) Traditionally, the experiences of college and university fund-raising efforts have shown that a few rich donors make up the predominant portion of most gift-giving programs. At times, 90 percent of all gifts received are provided by 10 percent of the donors. Much of this generosity by the rich has been encouraged by the full gift deductibility clause of the tax law that allows a full setting-off of current market value donations against active income. The use of some no longer valid provisions by former President Nixon to claim full deductibility of the value of his presidential papers has provided a justified impetus to the Congress and the Treasury to consider

wholesale reforms of the Tax Act. The House Ways and Means Committee, currently in recess, has been considering tax legislation all year. It has, among other matters, considered a minimum tax proposal, which could become part of a package that would force people with high incomes to pay a basic income tax regardless of their philanthropic giving. While it is too early to tell, such legislation, unless specifically exempting donations to public charities, could further compound the fiscal problems of the colleges. We do not agree with Harvard's economist Stanley S. Surrey that the income tax base can be effectively broadened by eliminating the special deductions for charitable contributions. The consequent reductions in charitable donations from the rich are not likely to be made up by middle-income groups.

While the considerations of tax reform are exceedingly complex, the social approach to the sharing of private and public responsibility toward educational, social, and cultural institutions is not. On principle, any policy that encourages the private sharing and support of the country's charitable institutions is consonant with the public interest, and every policy that discourages the widest possible private generosity is not in the long run in the public interest and throws additional burdens on the strained public treasuries.

A far better way would be to seek new avenues for private giving. This may be a good time to consider an excellent proposal by Alan Pifer, president of the Carnegie Corporation, which would provide a 50 percent tax credit on an optional basis. "Every taxpayer," Dr. Pifer proposed two years ago, "would be treated as if he were in the highest, or 50 percent, marginal bracket for salary and wage income for purposes of his charitable contributions. The effect of this, obviously, would be to give every taxpayer a 50 percent tax credit for his charitable donations. A person giving \$200 would, for example, get \$100 automatically knocked off his tax bill. For the sake of simplicity, this would be entered on the tax return as a tax credit after all other computations had been made, although in spirit it would remain a deduction and would have to be supported by the submission of an itemized list of contributions."

One is attracted to Dr. Pifer's proposal both for its functional simplicity and its reaffirmation of the tradition of private generosity. And we concur with economist Howard Bowen's recent observation that "attempts are being made in the name of equity to bring about a further relative decline in philanthropy by withdrawing some or all of the tax deductions. These efforts, though well intentioned, are misguided. The case is strong for arresting any further relative decline in philanthropy and for expanding voluntary giving. A counterweight to government of sufficient critical mass is still needed."

No segment of society could be more favorably disposed toward a more equitable tax base than the academic community. But no one should pretend to overlook the current possibility that serious mischief can result from a thoughtless legislative application of that principle. The evidence must be abundantly clear by now that eleemosynary institutions need maximum public support, not deprivation, and public policy must be clearly directed toward that end.

Senator HARTKE. Next witness we will hear will be Mr. Homer Wadsworth of the Cleveland Foundation.

#### STATEMENT OF HOMER WADSWORTH, DIRECTOR, THE CLEVELAND FOUNDATION

Mr. WADSWORTH. Mr. Chairman, it is a pleasure to be here. I provided for the committee a statement for the record.

My name is Homer Wadsworth. I am director of the Cleveland Foundation, and also have the honor of being vice chairman of the Council on Foundations at this time.

Mr. Chairman, we responded in Cleveland to your request that we have a look at the effect of the market on our operations, not only in the Cleveland Foundation, but in 11 other foundations in that area. It is the practice in the Cleveland area to meet quite regularly and exchange information on matters of common interest, and it was relatively easy for us to pursue this following your inquiry on



the matter. And I will refer to it in skipping over some portions of this paper, but covering its essence.

In the main, as I have indicated, we have suffered substantial paper losses. The study covering these 12 foundations shows that assets declined in amounts varying between 14 and 40 percent between the 1st of January and September 30, 1974. The experience of the Cleveland Foundation, the largest of the foundations reviewed, and the oldest of the community foundations in the country, is rather typical of the experience of all of them studied, and I will refer to that in some detail.

As of January 1, the assets of the Cleveland Foundation were \$168,600,000. At the end of September of this year, these assets had declined by \$40,970,000, or 24.3 percent. It is especially noteworthy, however, that the income of the Cleveland Foundation has remained constant throughout the current year. That is, we anticipate no impairment of earnings in the current year, in spite of paper losses of almost 25 percent. This simply means that we have not reduced our program services in the current year, nor have we cut back on the volume of grants issued to community agencies of all kinds.

About all that can be said of significance concerning current operations is that our dollars do not go as far as they did a year ago, a complaint that reaches far beyond the limits of our modest enterprises. It may be helpful to this committee to have our current estimate about activities in the year ahead, 1975. Our present thought is to increase our spending by 25 to 30 percent, and quite apart from any guesswork about market conditions. We wish to do so knowing that the agencies and institutions and individuals that we serve are under great stress these days, and that in many ways programs of the highest quality that have taken generations to build are in considerable peril, mainly because of economic uncertainty and inflationary conditions with which we cope. This is the time, in our judgment, to spend, and to thereby give encouragement to those who strive to hold together our essential services.

It is noteworthy, of course, that ours are marginal efforts at best, foundations having resources mainly calculated to provide research and development assistance and short-term aid to educational and charitable efforts. We are particularly fortunate in that community foundations are not subject to the excise tax imposed on private foundations, nor are we regulated in terms of the payout requirement required of private foundations. Money not paid in taxes is available for grantmaking. Money not paid out until it is needed is likely to be used most efficiently. Perhaps this subcommittee might consider giving the Treasury larger discretion in determining payout requirements for private foundations, at least to the extent of providing that some accumulations may be possible in circumstances where larger aggregates are required than one can anticipate in a single year.

This might take the form of seeking Treasury approval, for example, to spend 5 percent of assets in 1 year in order to have enough money to spend 7 percent of assets in a subsequent year, and on a specific program or programs requiring front-end financing, and the approximate amounts involved. It is certainly clear that the freedom extended to community foundations at this point serves well the community interests we foster, and that corresponding discretion, perhaps

checked by Treasury review, might have similar benefits to those aided by private foundations.

Let me add one or two other things that are a reflection of testimony this morning. I think it is well to bear in mind that foundations are a very modest part of the philanthropic effort in this country. People of America, unlike people anywhere else, give away almost \$25 billion a year. Most of that money comes not from foundations. It comes from average people who go into their pockets to support their churches and their schools, and their colleges and their PTA and the rest. The foundation enterprise is about 9½ to 10 percent of that total spending.

So therefore, when you get into a discussion of the law on foundations, you have to look at it essentially as the research and development funds with which we examine new evidence, determine new ways of dealing with problems, experiment. For those of us who work at foundation levels, we see about as much of local officials of government as we do voluntary agencies interested in money. At the moment, I have under consideration requests from the court system, from the Federal Government, from the State government, from the county government, from the city government, and any number of departments and agencies; many of them without that kind of front-end money for research and investigation that is necessary to improve on what we do and the way we go about doing it. And it seems to me much of the discretion of this subject ought to be brought around to the point where you deal with what foundations are capable of doing, and you recognize that if you eliminate this, what you do is make nice and gray and mediocre most of what we do.

The other point I would make is, it is not going to be very long before Government itself has to find ways to involve people in supporting what government itself wants to do, and it tends to dry up. And I think this is one of the reasons why many local agencies, apart from the fact that they are approaching bankruptcy, are also interested in having support from private, nonpartisan, unbiased, objective agencies that on merit are willing to consider things that they propose.

Mr. MARLOWE. While we are waiting for Senator Hartke to come back, let me ask you a couple of questions, if I could. You are a community foundation?

Mr. WADSWORTH. That is right.

Mr. MARLOWE. I gather from your prepared statement something that did not come across to me fully when you gave an oral statement. There was a little bit more optimistic picture when I read your prepared statement than you were giving now. Was my impression incorrect, or do you feel that the picture for foundations, at least in the northeastern Ohio that you surveyed, is a little bit better than the pictures that some other foundations may have presented here?

Mr. WADSWORTH. Well, I think that foundations that have primarily been operating from income—and not by virtue either of policy or anything else, of invading assets—are doing about as well as they were doing a year ago, and I do not think our experience is any different than others. My feeling is that much of the attention given in the press to the so-called plight of the foundation arose out of consideration of the Ford case, which I regard as really very atypical. Ford, after all, set out a number of years ago to reduce its assets, and made certain calculations on the assumption that the market would never

turn down. I think those of us who, in the main, operate from income have not been hurt very severely. I think, as a matter of prudence, one has to take a fairly cautious look at 1975. But as I pointed out in my statement, it is somewhat advantageous not to be under pressure to meet a payout, which is one of the privileges that the Congress has given the community foundations.

Mr. MARLOWE. You mentioned the Ford Foundation, but there was also a major article in the Wall Street Journal on October 1 of this year, which mentioned several other foundations, some of which, quite honestly, I had never heard of before. So they must be—certainly, of course, of less size, but of less notoriety than the Ford Foundation. I do not recall that any of the foundations in Ohio were directly mentioned. I see one affiliated with the Sloane Kettering Institute mentioned, but I am trying to draw a distinction as to what may be happening in Ohio as compared to what may be happening nationwide, and whether you have any better fund management, investment management, or whether it is just a question of the particular group involved in the survey.

Mr. WADSWORTH. I do not think we have any better fund management than anybody else. I think Mr. Bolling put his finger this morning on the essential problem that is involved; namely, that in the period of downturn, trustees become supercautious, and one can hardly blame them, particularly if you are managing private funds and you are subject to as much constraint as those who manage private foundations now have to deal with. Community foundations are in a very privileged position, you see. We are given what it seems to me every foundation needs, and that is a high degree of flexibility. If you are only spending less than 10 percent of the philanthropic dollar, there had better be some flexibility in the way in which that is managed, and the way in which it is used.

Now, the Congress has said, for I think very good reasons, that the community foundations may continue to have this privilege. I wish that the Congress would press the Treasury a little bit, and get us some regulations. We have been sitting around for 5 years, waiting for those.

Senator HARTKE. I find that that is a legitimate complaint, and I think you are wholly justified, and we will write them a letter again, saying that we think 5 years is long enough to get out a regulation.

Mr. WADSWORTH. I appreciate that, sir.

Mr. MARLOWE. I had only one more question, Senator. You talked about foundations obviously not being in difficulty if they are just going into their income. The experience of the foundations that you surveyed in the Cleveland area—will they be able to stick to that pattern if they had been just distributing out of income, or will they be forced to go into assets?

Mr. WADSWORTH. I think that the study shows—and I have attached a copy of it to my remarks—that for the most part, the foundations in eastern Ohio surveyed will hold pretty close to their present pattern of giving, unless the market condition worsens greatly. Psychologically, there will be a little bit of press in the private foundations in the group to spend cautiously. I assure you, as the biggest of the foundations in eastern Ohio, we are tending to in the other direction; that when things are tough, we ought to be prepared to spend more liberally, and this is our own judgment about it.

We are quite aware of the difficulties under which those who come to us are facing, and as I indicated, Senator, this applies not only to private colleges and universities, it applies as well to units of government. At the moment, I have well over 20 applications from agencies of government for studies of all kinds, for experimental effort in the juvenile field, and in the administration of justice and child welfare; in effect, almost across the board with research and development activity that government itself cannot finance at the local level, and all exceedingly important, ranging all the way from the examination of tax-delinquent property in the city of Cleveland to the operation of the juvenile court system. And not at the request of private citizens who want to raise Ned, but at the request of properly constituted public officials, elected to offices. This is the condition that we face, and this is the response we are trying to make to that condition.

Mr. MARLOWE. You mentioned—

Senator HARTKE. Well, that is a new form of revenue sharing, is it not?

Mr. WADSWORTH. Yes, yes, that is right. As a matter of fact, one of the requests we have is for assistance to the city of Cleveland in management of revenue sharing funds allocated to them.

Senator HARTKE. Do you really think that is a proper function of a foundation?

Mr. WADSWORTH. Let me be clear as to what the request is. The request is for technical assistance in setting up a management system to give the city better control of what they do with money, and the refereeing of the multiple payments.

Senator HARTKE. Why should the city not pay for it?

Mr. WADSWORTH. If the city had it, I think very much they would. But the city is very much like the city of New York yesterday. They just laid off hundreds of employees as the result of the failure of a lev. drive in a local election. The pressure on local government in a recession like this is very severe. There will be over 1,000 employees—

Senator HARTKE. Then I think the Congress ought to go back and say, we refuse to go along, too, because after all, some of those same officials come on back and are complaining about this wild-spending Congress; and the best way to do that is close that tax loophole, which is financing these cities through the back door, because the cities do not have the courage to face up to their own tax responsibilities. Why should you use Federal tax dollars, a subsidy out of a foundation, to subsidize local government; because local people do not have the courage to face the voters, right?

Mr. WADSWORTH. Let me be clear. The best any local foundation can do is at the request of officials to support a study of a problem. The question you raise is the question of whether you have an equitable distribution of the tax dollar. As long as your major sources are monopolized by the Federal Government, then some means by which money necessary to run vital services gets back into local communities has to be devised. So far, revenue sharing is one of those devices. Whether it is successful remains to be seen.

Senator HARTKE. I think that is doing through the back door what you cannot do through the front door, and I just think that type of duplicity should not be permitted, and I think that is what it is.

Mr. WADSWORTH. I am not sure that I understand what you are getting to, Senator. If an official of—

Senator HARTKE. What I am saying, simply, is if the local government refuses to pay its own bills and assume its own obligations, and goes back and takes advantage of a tax subsidy given to a foundation in which the donor is going ahead and avoiding his tax responsibilities, I do not see how you can very well justify that.

Mr. WADSWORTH. Would you say that if the judges of a juvenile court come to a foundation, and ask the support for a study of how to improve the practices of that court, that this is not a legitimate request to be considered?

Senator HARTKE. I do not think it is a legitimate request of a foundation, no.

Mr. WADSWORTH. In effect, the court ought to sponsor its own studies?

Senator HARTKE. I certainly think so. They ought to go to the people, and put it on the table before the people, and say, if you want a better court system, you are going to have to pay the bill.

Mr. WADSWORTH. Well, you know, paying the bill for a good court system is not the same as financing a study.

Senator HARTKE. You ought to pay the bill for financing the study if you want a better court system. You ought to pay the bill to finance the study. This dodging responsibility and ducking around, and sneaking through the back door, to me is one of the things that people hate now. That is why they have no confidence in government.

Mr. WADSWORTH. I can agree we had better be prepared to pay for what we really want as citizens.

Senator HARTKE. Pardon?

Mr. WADSWORTH. I agree we ought to be prepared to pay, as citizens, for what we really want. No problem with that.

Senator HARTKE. That is why I think it is foolish for us in Congress to talk about the fact that we are going to be fiscally responsible and permit the foundations to be fiscally irresponsible.

Mr. WADSWORTH. Well, I would have to take issue with your view that foundations are fiscally irresponsible.

Senator HARTKE. You mean to say to me it is not fiscally irresponsible to say to the city government, if you want a study of your city court system, you pay for it?

Mr. WADSWORTH. Well, I—

Senator HARTKE. Well, say the people of Cleveland go back and say, look, Cleveland, if you want a better court system—your court system is not working—you are going to have to pay for it. This is not a case of anything except the government working.

Mr. WADSWORTH. Well, there are other aspects of this, you know. The question is not what sort of study, but to what extent will it be accepted by people as the basis on which to determine at what level they wish to finance a public service? Sometimes, it is a matter of just reasonable strategy to look for other ways to fund it.

Senator HARTKE. Well, there is no law against it.

Mr. WADSWORTH. It is a judgment question, you know. Sometimes we turn them down, and sometimes we accept them.

Senator HARTKE. I think that is a political decision, a pure and simple political decision. I do not think it is a judgment question. It is

a question of whether the city wants to pay its bills; and if you want to share revenue with them, if you want to do that, if you want to put it back on a different basis and change the method of collecting taxation, I am in favor of it. But I am not in favor of the subterfuge.

All right. Thank you.

Mr. WADSWORTH. Thank you.

[The prepared statement and the following material was submitted by Mr. Wadsworth:]

PREPARED TESTIMONY BY HOMER C. WADSWORTH, DIRECTOR, THE CLEVELAND FOUNDATION, PRESIDENT, GREATER CLEVELAND ASSOCIATED FOUNDATION, CLEVELAND, OHIO

The charitable foundations of America are alive and well and going about their appointed tasks much as they have been doing for several generations. They have not suffered serious impairment as a result of adverse market conditions in the current year, or so it would seem from a survey of public and private foundations in Northeastern Ohio just completed by the staff of The Cleveland Foundation. A copy of the survey results and a sample of comments on key questions asked of twelve such foundations in a recent telephone inquiry is attached hereto.

This is not to say that these institutions have not suffered substantial paper losses. The study shows that their assets declined in amounts varying between 14% and 10% between January 1st and September 30, 1974. The experience of The Cleveland Foundation, the largest of the funds reviewed and the oldest community foundation in the nation, is rather typical of the experience of all of the foundations studied.

The market value of The Cleveland Foundation on January 1, 1974, was \$168.6 million. At the end of September of this year these assets had declined \$40.97 million, or 24.3%.

It is especially noteworthy, however, that the income of The Cleveland Foundation has remained constant throughout the current year—i.e., we anticipate no impairment of earnings in the current year in spite of paper losses of almost 25%. This simply means that we have not reduced our program services in the current year, nor have we cut back on the volume of grants issued to community agencies of all kinds. About all that can be said of significance concerning current operations is that our dollars don't go as far as they did a year ago—a complaint that reaches far beyond the limits of our modest enterprises.

It may be helpful to this subcommittee to have our current estimate about activities in the year ahead (1975). Our present thought is to increase our spending by 25% to 30% in 1975, and quite apart from any guesswork about market conditions. We wish to do so knowing that the agencies and institutions and individuals that we serve are under great stress these days, and that in many ways programs of the highest quality that have taken generations to bring to their present levels are in considerable peril, mainly because of economic uncertainty and the inflationary conditions with which we must cope. This is the time for us to spend, as we see it, and to thereby give encouragement to those who strive to hold together our essential services.

It is noteworthy that ours are marginal efforts at best, foundations having resources mainly calculated to provide research and development assistance and short-term aid to educational and charitable efforts. We are particularly fortunate in that community foundations are not subject to the excise tax imposed on private foundations, nor are we regulated in terms of the pay-out requirement required of private foundations. Money not paid in taxes is available for grant-making; money not paid out until it is needed is likely to be used most efficiently.

Perhaps this subcommittee might consider giving the Treasury larger discretion in determining pay-out requirements for private foundations, at least to the extent of providing that some accumulation may be possible in circumstances requiring larger aggregates than is possible in any one tax year. This might take the form of seeking Treasury approval, for example, to spend 5% of assets in one year in order to have enough money to spend 7% of assets in a subsequent year, and on a specific program or programs requiring front-end financing in the approximate amounts involved.

It is certainly clear that the freedom extended to community foundations at this point serves well the community interests we foster and that corresponding discretion, perhaps checked by Treasury review, might have similar benefit to those aided by private foundations.

THE CLEVELAND FOUNDATION,  
GREATER CLEVELAND ASSOCIATED FOUNDATION,  
Cleveland, Ohio, November 12, 1974.

Attention: Michael Stern, staff director.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations, Committee on Finance, U.S. Senate,  
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR HARTKE: For the past several years, representatives of foundations in Northeastern Ohio have met together periodically to share information on grant proposals and discuss mutual concerns. At its meeting on Monday, November 4, 1974, notice of the hearing of the Finance Subcommittee on Foundations concerning the impact of the current economic crisis on foundations came to our attention.

Members of the group are pleased to have the opportunity to submit to the Subcommittee information which we hope will be helpful. The following questions, similar to those used by other foundations in the country, were presented to eleven other foundations. The names of those foundations are listed at the end of this letter.

1. What does the 1974 economic downturn mean for foundation assets and income?
2. What does the 1974 economic downturn mean for foundation expenditures and budgetary planning?
3. What particular effects would reductions in foundation giving have on various types of donee institutions?
4. What are the effects of inflation on the foundation and typical donees?
5. In current economic conditions, are losses to charity represented in the 4% tax worth what is being brought into the Federal Treasury?

Attached is a composite report of the data collected from 12 foundations, including The Cleveland Foundation. Thank you for your consideration.

Sincerely,

HOMER C. WADSWORTH, Director.

Enclosure:

QUESTIONS RELATED TO CURRENT ECONOMIC DOWNTURN ON ASSETS, INCOME, EXPENDITURES AND BUDGETARY PLANNING FOR 1974

Fdn.	Assets (approximate) (percent)	Income	Expenditures (estimated)	Budgetary planning
I.....	-40	Constant.....	Anticipated down 25 percent in 1975.	Not applicable; no staff expenses.
II.....	-14	Down—no longer spending principal.	Down—no estimate.....	Delaying decisionmaking to assure current commitments are met and to support long-time donees.
III <sup>1</sup> .....	-21	Up 10 percent..	Up 10 percent.....	
IV.....	-20	Constant.....	Anticipate no change.....	Project income up slightly for 1975.
V.....	-18	Up 12.7 percent.....	do.....	No staff expenses; bank fees have declined slightly.
VI.....	-25	Constant.....	Increase by \$200,000 in 1975....	No staff expenses.
VII.....	-18	Up 5 to 10 percent.	Up 10 percent over 1973.....	Hoping for asset appreciation in 1965; assume 6 percent distribution requirement for 1975.
VIII.....	-40	Constant.....	Anticipate decline.....	Plan not to continue invasion of principal until economic upturn occurs.
IX <sup>2</sup> .....	-35	do.....	do.....	Plan for careful consideration of requests; discontinue principal invasion.
X.....	-30	Up 12 percent...	Anticipate maintaining current levels.	Reduction not planned for present.
XI.....	-23	Constant.....	do.....	Do.
XII <sup>2</sup> .....	-24	do.....	Anticipate decline up to 10 percent in 1975.	Plan possible decrease in administrative costs.

<sup>1</sup> Community foundation.

<sup>2</sup> An association of trusts and foundations; composite figures.

Source: Cleveland foundations composite survey, Nov. 12, 1974.

**COMMENTS REGARDING EFFECTS ON DONEE INSTITUTIONS OF REDUCED FOUNDATION GIVING**

I. Some grantee activities will have to be curtailed; some studies and research projects funded will have to be halted for lack of support and the work done thus far perhaps wasted. No new grant obligations can be undertaken, regardless of worthiness.

II. Where Foundation's gift generates matching grants, constitutes sizable portions of project budgets, or sustains a project (majority of grants), reduced funds could be devastating.

III. Where Foundation provides an annual gift, support will continue at current level. Fewer projects can receive seed money.

IV. Since portion of Foundation's grants provide scholarship assistance, reduction would affect directly students in need of financial assistance. Majority of donees are smaller agencies with special projects and equipment replacement requests; short-term effects on this group would involve postponement of equipment replacement and special project initiation.

V. Fewer innovative and performance improvement programs funded. Less operating income for the major cultural and educational programs which Foundation supports.

VI. Anticipate they will be able to provide normal level of operating support monies to donees.

VII. Assume donees will have two options: (1) cut back expenditures; or (2) seek out additional funds. In majority of cases, donees will have to revise downward planned expenditures.

VIII. Institutions are having to wait longer for payment on committed grants, for Foundation is reluctant to sell securities in poor market.

IX. Since Foundation feels they must maintain reserve for emergencies, only the highest priority projects are receiving serious consideration under present circumstances.

X. Foundation does not anticipate any reductions in grants to donees at present time.

XI. Foundation does not anticipate any reductions in grants to donees at present time.

XII. Some decreases in donee operational levels would appear likely since the uncertainty of public funds in many areas precludes many organizations looking to public programs as alternative sources of support. Arts and education appear to be the areas which would most severely be affected.

**WHAT EFFECTS HAVE INFLATION HAD ON THE FOUNDATION AND ON ITS TYPICAL DONEES?**

I. Activities of donees will be limited because of inflated costs. Foundation has no administrative expenses.

II. Foundation dollar income from securities has actually increased in some instances because of inflation; since Foundation has practically no overhead, it has not suffered negative effects from inflation. Donees are seeking more dollars from foundations to meet rising operational costs and to make up gifts no longer as available from individual and corporate donors.

III. If the Foundation provided funds in relation to inflationary increases, it would be faced with an additional 12-15% increase in grants.

IV. Inflation has not substantially affected Foundation's operations, but donees have been hit severely.

V. Foundation has realized some increase in income because of inflation. Donee pressure is increasing for higher grants to maintain services at the same level.

VI. The trustee bank raised its fees to administer Foundation assets. Some donees are requesting additional support because of rising costs.

VII. Foundation has had increased income from some assets, although unable to predict whether income will continue to grow at rate which reflects inflationary rate. Foundation will aid donees to offset inflation; donees will have to make activities more efficient.

VIII. Foundation has noticed that projects submitted for funding cost more. No discernible effects of inflation on Foundation itself.

IX. With project costs higher and income constant, the gap between what is requested and what is granted to support a specific project is increasing.



X. Foundation has no real administrative expenses, so inflation has not affected operations. Foundation does not anticipate any effects because it makes only project, not sustaining, grants.

XI. Foundation has no administrative expenses and has not seen any inflationary effects in donee requests.

XII. If planned increases in grant expenditure levels for 1975 hold up, this would enable grantees to offset, at least in part, the impact of inflationary economy. Conversely, if Foundation income declines drastically, as donee income falls, the total effect would be disastrous to grantees.

**IN YOUR JUDGMENT, ARE THE LOSSES TO CHARITY REPRESENTED BY FOUNDATIONS PAYING A 4-PERCENT TAX INTO THE FEDERAL TREASURY WORTH THE IMPACT ON DONEE INSTITUTIONS?**

I. If the money paid in taxes had gone directly to fill grant requests this year, it could have been used wholly for medical research, hospital or library programs, and scholarships.

II. Though the 4% tax is not a great burden to the Foundation, the money cannot go to both the government and to donees. It is more likely that the amount paid in taxes would be vastly more meaningful to many donees than it is to the government.

III. Not applicable; community foundation.

IV. Not applicable; community foundation.

V. This tax is anti-inflationary, as it transfers money from the Foundation to the government. However, since the Foundation's primary donees are interested in maintaining economic self-support, in preventing or limiting neglect, abuse, etc. and to the extent they are not served, society suffers. Output is less, productivity is lowered, and the economy is worse from unavailable funds in critical areas.

VI. What is paid in increased taxes could otherwise have been granted to needy institutions.

VII. The tax is not a tax on foundations; it is a tax on donees because it lowers the level of support available to charitable institutions.

VIII. Under ordinary conditions, Foundation provided for 4% tax by invading principal. Now, the tax monies must come from income.

IX. In the past, the tax has not seriously affected the foundation's granting capacity because principal could be spent to maintain the desired expenditure level. Now, taxes and grant payments must both come from income.

X. Charity is really losing. The supervision of foundations cost the government between 1% and 2%, net 4%; everything about the cost of supervision is a direct tax on charity.

XI. The expenses of the Foundation's audit are justified; anything above that is a tax on charity.

XII. Not applicable; community foundation.

Senator HARTKE. The next witness is Mr. William L. Bondurant, executive director of the Mary Reynolds Babcock Foundation, Winston-Salem, N.C. I have a problem, sir. I am going to permit Mr. Marlowe to conduct the rest of the hearings, if it is all right with you. I am going to a conference committee on hazardous materials, and I just want you to know that we will try to go ahead and save a few lives with that this afternoon.

Mr. BONDURANT. I certainly would not step in the way of that, sir.

Senator HARTKE. All right.

I will let you take over.

**STATEMENT OF WILLIAM L. BONDURANT, EXECUTIVE DIRECTOR,  
MARY REYNOLDS BABCOCK FOUNDATION**

Mr. BONDURANT. Mr. Marlowe, I am William L. Bondurant, executive director of the Mary Reynolds Babcock Foundation of Winston-Salem, N.C., which is a general purpose foundation with assets of around \$21 million.

I might add also that I have recently served as the head of a major department in North Carolina, the Department of Administration, for the past 18 months, and my remarks today will in some way reflect my experience working in State government as secretary of administration, as well as my previous 4 years working with the Babcock Foundation and now in my position as executive director.

The 1969 Tax Reform Act was in our judgment a constructive response to conditions existing both at that time and to a great degree still existing. From the point of view of the management of a private foundation, the horrors which many people expected when the act was passed simply have not come, and the act has been both stimulating and constructive in a number of ways, such as providing more accountability to the public who are in a sense shareholders of foundations, less likelihood of foundation control of family corporations, and better monitoring of foundations by the Internal Revenue Service.

However, the Tax Reform Act was not designed to deliberately cause the liquidation of foundations over a certain number of years. Forced liquidation of foundation endowments was debated and rejected as ultimately not in the best interests of our society.

Unhappily, it now appears that economic conditions are doing just what Congress sought to avoid. The depressed stock market and inflation are reducing both the assets and the effectiveness of foundations to an alarming degree.

Now, I do not propose to speak as the representative of a class of foundations, but I have reason to believe that there are a number of moderate-size foundations who share our experiences.

The Babcock Foundation was created in 1953 by the will of Mary Reynolds Babcock as a general purpose foundation devoted to improving the human condition. Its primary beneficiaries have been private colleges and universities in the South, mostly in North Carolina, although it has made grants over the years to support a wide variety of charitable, scientific, educational, or social welfare activities around the nation. Initially endowed with \$12 million in 1954, and with additional capital contributions of around \$5.5 million for a total capitalization of \$17.6 million, the foundation has paid grants totaling \$33.2 million over a relatively short span of years. Every one of these, incidentally, has gone to a tax-exempt, nonprofit organization except in the case of one small grant to a nonprofit organization which will soon be tax exempt.

Based on capitalization of \$17.6 million and making grants totaling over \$33 million, we have over the years granted in excess of \$9.1 million from capital in addition to grants from income. Indeed, we have made grants in excess of income for 14 of the 21 years we have been in existence.

Thus, this foundation, similar I believe to many foundations, has strived over the years to do the right things in the most efficient ways: to grant both capital and income, to support only tax-exempt programs, to maintain low overhead and to aid a variety of notable institutions seeking to solve important problems in innovative ways.

I wish we had time to explore some of the exciting things that are being done with these funds. And, after all, that is what our efforts are all about, but I must push on to analyze specific economic effects on

the foundation in four areas: what has happened to our market value, our income, our annual payout in relation to our income, and our overhead. We shall then briefly look at the impact of inflation on the foundation, a projection of the effects of a continuation of present market conditions, and finally a modest proposal.

I have included in the testimony copies of the charts that I have up here, and I will not spend but one or two sentences on each of these charts.

I have selected 3 years at 5 year intervals, 1964, 1969, and 1974, as the best way to see the effects of economic conditions on the foundation.

What has happened to our market value? In 1964 the foundation held \$37.1 million in assets at market value. By 1969 our assets had declined to \$32.5 million, and by 1974 our market value was \$21.6 million. Thus in 10 years, the foundation's market value has declined by 42 percent. Of course, this was due in part to our granting funds from principal.

What has happened to our income? In 1964 the foundation's gross income was \$1.7 million. By 1969, annual income had decreased by \$237,000, and in 1974, it was \$1.2 million. Thus, in 10 years, gross income declined 32.8 percent.

What has happened to our annual grants payments in relation to our annual income? In 1964 the foundation paid out 4.4 percent of its market value. This expenditure exceeded income in 1964 and required our carrying forward an income deficit for that year. In 1974, the foundation paid out 7 percent of its market value. A little over half of that was covered by income, and again the foundation has carried forward an income deficit. We also paid some from principal that year. We began our fiscal 1975 year with contingent liability for grants in excess of 1.8 million.

What has happened to our overhead in the meantime? In 1964, and again in 1969, the Babcock Foundation's overhead was 8 percent of grants paid. In the past 5 years, when income has decreased by \$348,000 and inflation has nationally increased operating costs, our operating costs have risen to 14 percent of grants paid. However, I might point out that the 1969 Tax Reform Act has caused the foundation to incur several new operating expenses, accounting for at least 4½ percent of the increase from 8 percent to 14 percent.

We might compare this with the Federal office probably most similar to the foundation in program interests. According to the appendix of the Budget of the U.S. Government for fiscal years 1969 and 1974, the Higher Education Activities of the Office of Education, HEW, which expends more than 100 times what we do, reported an overhead of 24.1 percent in 1969, and 21.8 percent in 1972.

What has been the impact of inflation on the foundation? Between 1964 and 1974, the purchasing power of the dollar has declined by 46.8 percent according to the "Survey of Current Business," October 1974. Thus, the foundation would need an income of \$1.9 million to produce the same monetary results in 1974 as it did in 1964. Our income for 1974, in fact, was \$1.19 million or only 62.6 percent of the amount needed to remain at the same level of monetary effectiveness as 10 years ago.

This chart, incidentally, is the third chart in the testimony that you have there, and it indicates the level of grants in 1964, 10 years ago.

This line shows the required income that it would take to continue the same efficiency in the ensuing years, and this line is our real income, during the period.

And then the final chart, if past or current economic trends continue, what will be their impact on this foundation? The foundation's market value has declined by 33 percent in the last 5 years. If this continues, our assets will be down from \$21 million to \$15.3 million in 5 years. Assuming the same income rate we have had for the past 5 years, 5.15 percent, and ignoring the depletion of principal produced by the required 6 percent payout, the foundation will have only \$788,000 to grant from income in 1979.

Now, assuming a 5-percent rate of inflation over the next 5 years, our income for 1979 would have to be \$2.3 million to match our 1964 purchasing power. If the projected income is correct, the foundation will have only 34 percent of its 1964 purchasing power in 1979. Thus, in 15 years we will have seen a decline of 66 percent in the foundation's ability to assist worthy causes.

What can be done to improve the future economic situation of the foundation? As our statistics indicate from a fiscal point of view, the future of this foundation and indeed of all endowed organizations, is not bright. Our board, our investment advisers, and our staff are doing all that they can to respond to these pressures in reasonable ways. Yet the combined forces of inflation and recession continue to seriously threaten the erosion of our resources and of our effectiveness. The solutions to these joint pressures will certainly have to be national in proportion, and surely it will take all of our best efforts to find them. However, I would like to put forth one small recommendation that might be of assistance in the national effort to understand and deal with the total questions of philanthropy, tax inducements, encouragement of the private sector's participation in meeting public needs, and all of the myriad of things that the Filer Commission is studying. May I suggest that consideration be given to the use of some of the surplus funds generated by the 4-percent excise tax to establish a permanent Commission on Private Philanthropy and Public Needs? Such a Commission, with no regulatory power whatsoever, could be charged with the duty of updating the information gathered by the Filer Commission and serve as an objective source of current information to the Congress and the people of the United States.

Mr. Chairman, the Babcock Foundation has been able to make grants totaling \$33 million in the last 21 years largely because our board has chosen, in an expanding market, to make grants from principal. Now that that principal fund has diminished considerably, we shall find it very difficult and painful to continue doing so. Major relief can come primarily in the form of a stronger economy, although of course some relief would be felt too by the reduction of the excise tax and minimum payout requirement. Any steps which the Congress can take to strengthen the economy and to reduce inflation will, through strengthening foundations, benefit the educational scientific, charitable, and religious causes which both Government and private philanthropy must support.

I have a page of financial data, the next page in the testimony here, that confirms some of the figures that I have given, and the next 4 pages are charts. I speak from the point of view of a small foundation

down South where for the last 21 years we have sought to be innovative and to do the job that we felt needed to be done, primarily in our part of the country where there certainly are far more problems that we can say grace over, but occasionally sortieing out of the South to pick up a few good ideas from up here in the East, out yonder in the West, or wherever else, and occasionally to bring them back to the South.

It strikes me at this particular time when the effect of inflation upon our assets and upon our effectiveness is most acutely felt, that this is certainly not the time to take steps that would discourage the creation of private foundations or philanthropy, but indeed to encourage it, and I trust and hope that the Congress of the United States will very seriously look at the market conditions affecting philanthropy.

I also hope that opportunity will be given for foundations to speak again to the subject of what they are all about. We can focus too much on the question of the tax advantage that may help create foundations in some cases and yet overlook the importance of the job that foundations are doing relative to the revenue lost by that tax advantage.

I would be delighted to come back at some time and talk about some of the, I think very exciting things that are going on as a result of initiative of individuals who then come to foundations and seek that pilot money to get their programs underway. Indeed, I would be happy to talk about it for the next 2 hours, if I could, but I will not do that to you.

Mr. MARLOWE. Thank you, Mr. Bondurant. First I want to apologize to you and to the other witnesses for the lateness of the hour and the other conditions which are prevailing here, and hope that if there is any wrath to be directed, that it be directed at me rather than at any member of the committee. And I think it is very clear from what the chairman had to say that he would enjoy that conversation with you for whatever time it took.

Both he and Senator Gravel today really spoke to the practicalities, albeit the underlying philosophy, but the practicalities of it from our point of view. If we are going to recommend anything to the Senate about the change in the tax law affecting foundations, we are going to have to sell it, and I think Senator Hartke alluded to the fact that he would have difficulty selling, and perhaps Senator Gravel made the same types of statement, and difficulty not so much because it is the fault of the foundations, but because I do not think that the story of what foundations are all about has been told, and I do not think it is certainly evident to Congress just what the story is.

I think the proof of that is in some of the recent developments over in the Ways and Means Committee affecting the 4-percent excise tax where at least on at least two occasions they rejected reducing the tax; and yet it is clear from the statements of the members of this subcommittee back in October that that is one tax which has to be at least reduced because it affects the people who need that money the most.

Let me ask you a couple of questions that come to my mind, and then one which I know came to Senator Hartke's mind when he read the summary of your testimony last night.

Have you been forced to go into assets in order to meet minimum payout requirements?

Mr. BONDURANT. No; we have exceeded minimum payout requirements. We have not been forced to, but we have gone well above minimum requirements voluntarily.

Mr. MARLOWE. Incidentally, I also wanted to take some recognition of the fact that you are, I believe, part of the Southeastern Council?

Mr. BONDURANT. Yes.

Mr. MARLOWE. Which has just had a conference, I think, and has been doing an excellent job in promoting cooperation among foundations in that part of the country, I think that was another reason that we were particularly happy to have someone from other than the usual area that we get foundations here today.

You recommended at the end of your statement that we make some adjustment in the 4-percent excise tax, but also in the minimum investment return?

Do you have any recommendation for us along that line?

Mr. BONDURANT. I am not an economist. I would simply echo the remarks that have been made earlier today. It should be based on broader considerations than what the Federal Government pays as the minimum interest payments.

I would say that to hit a figure of 5 or 6 percent and sock it in as a figure would today be reasonable from our point of view, I think figures that appear reasonable in 1969 and 1968, given the market conditions at that time, may turn out to be quite counterproductive, if the basic assumption is correct that private philanthropy and diversity of decisionmaking as to how we can best meet the burning needs that seem to beset mankind over the years should be widely spread out among the people of the United States by way of foundations or whatever boards may meet and choose. When that basic decision is made that we do not want to liquidate foundations, I think one must be prepared to adjust the payout according to market conditions which, as my figures here show, are eroding foundation assets. An arbitrary figure, the effect of which is to invade consistently the principal of foundations and to do, as the Senator spoke about earlier, by the back door what was not done by the front door, which is to say to cause foundations to liquidate when publicly we are saying we are not really doing that, is not the most admirable way of doing it.

Mr. MARLOWE. Mr. Bondurant, this strikes me as a unique opportunity for me to ask the type of question that staff people always would like to ask.

One of the problems that I am faced with here is trying to reach out to more and more people, both in the foundation community, the public and academia, for information. You talk about the need for a Permanent Commission on Private Philanthropy and Public Needs, something after the Filer Commission finishes its work, and although I do not want to equate the two, that is a point I am making with the recommendation that you have, but I am wondering what you might recommend to me that I do to reach out beyond the normal sources of information that we have, to reach out to more people in the foundation community, to more people who are interested in philanthropy, in order to get information, to get advice, and to get guidance for the subcommittee.

Mr. BONDURANT. Well, first, let me say that my impression from talking with colleagues at the Council of Foundations and with what

might broadly be called trade organizations for the foundations—and that is not exactly the word I want—is that you have indeed been diligent in trying to go through those channels to whom we as a foundation relate and try to give information, and second, the invitation to the foundations to testify here, to which I responded and to which others have responded, would certainly help to accomplish that.

I think quite candidly that 1969 taught foundations a pretty significant lesson, that they simply were not prepared to respond to the kind of questions that you are asking right now, and certainly not in 1969. I think hopefully we are better so today.

I would be happy to take it on as a personal mission to see if I could not on fact open any sorts of doors so that you could find information that you want, and I am sure that with the power of your position as a staff member for this particular committee, you probably do not have much trouble getting the information that you want.

But I do think the foundations have been negligent in this respect in the past, and I think this indeed was one of the reasons the Southeastern Council of Foundations was created.

The 1969 Tax Reform Act has greatly helped us in making information available to ourselves and through the 990 AR's, to the Congress and to the IRS, but I think there is a great deal more we could do in that regard, and needless to say, it occurs to me that whereas the Federal Government and the State governments generally deal with problems in a symptomatic basis, a flood, a fire, or a famine, the tax dollar has to go and deal with it, the foundations have the opportunity, indeed the duty to deal with causation and to say, well, now, 10 years from now how can we prevent that flood from coming back again, or in 5 years from now, the famine. This is the kind of thing I think that is going to be with us from now on, and I think that foundations have a tremendous story to tell about their efforts to deal with causation. Somehow they are not getting that story across as well as they could and as well as they should.

I am distressed in a way to hear your comment, and the Senator's comment, about having to defend foundations. Perhaps I am wrong, but I equate foundations with the effort to deal with the timeless, burning problems of our day, and of tomorrow and of yesterday, hatred, bigotry, mendacity, the serious problems that have beset mankind since the year 1. We must deal with these and we cannot expect Congress or the tax dollar alone to deal with them. I do not think we will ever get through dealing with them. But I believe that foundations have an opportunity to look beyond the battlefield of today, to look beyond the skirmish of symptomatic relief, into the broader fields of causation and to seek permanent solutions. For example, I remember in the early 1900's the Rockefeller Foundation, in a time which was unpopular for private or public money to do this, came to North Carolina and set up a program to eradicate hookworm. The State government lambasted them for it, the local politicians and the local leading citizens who were not politicians thought this was an invasion of northern ideas into the South, and yet before several years had passed, it became a very acceptable thing.

Indeed, the State and the Federal Government then picked up on the programs in succeeding years. but at the time it was done, it was most unpopular politically. The State of North Carolina has in fact

benefited greatly from that, and I do not believe that the Congress or the State government would have done anything. I simply do not think they would have.

I am beginning to feel that you have given me a platform, and I am sorry I have taken more liberties than I was allowed.

Mr. MARLOWE. Thank you very much.

I hope that the subcommittee will take up your offer to come back and discuss some of these underlying issues, but I will put the condition out that if you would like to talk 2 hours on that, then I would like to talk to you 2 hours about the difficulties that Congress has in acquiring the information it needs in order to make policy decisions, because I think we have both got something to talk to each other about.

Mr. BONDURANT. I will consider that a mutual offer, and will look forward to following up on it.

Thank you.

Mr. MARLOWE. Thank you.

[The following material was submitted by Mr. Bondurant:]

FINANCIAL DATA—SEPT. 11, 1953, THROUGH AUG. 31, 1974

Fiscal year ending	Net income	Total grants committed for payment	Excess or (deficiency) of income	Grants payments
1954.....	\$41,017.69	\$129,500.00	(\$88,482.31)	\$39,000.00
1955.....	439,820.06	1,165,070.22	(725,250.16)	428,570.22
1956.....	615,008.05	1,127,000.00	(511,991.95)	913,901.91
1957.....	662,275.97	624,589.64	37,686.33	680,772.90
1958.....	721,509.16	345,786.20	375,722.96	908,495.40
1959.....	771,700.62	1,276,951.87	(505,251.25)	839,282.50
1960.....	872,782.99	1,371,927.00	(499,144.01)	894,092.00
1961.....	1,010,001.95	692,577.02	317,424.93	912,596.30
1962.....	1,178,304.55	1,524,633.35	(346,328.80)	1,569,752.63
1963.....	1,235,489.85	2,407,093.01	(1,171,603.16)	1,541,512.51
1964.....	1,339,437.09	1,908,790.39	(569,353.30)	1,647,544.83
1965.....	1,687,440.89	5,799,012.43	(4,111,571.54)	5,925,617.71
1966.....	1,394,644.19	1,173,100.00	221,544.19	1,307,795.63
1967.....	1,443,834.76	1,132,119.83	311,714.93	1,594,035.94
1968.....	1,467,130.95	2,145,759.30	(678,628.35)	1,546,693.30
1969.....	1,427,299.78	985,266.45	442,033.33	1,469,946.65
1970.....	1,398,292.56	3,635,023.22	(2,236,730.66)	3,816,865.22
1971.....	1,290,130.86	1,411,123.91	(120,993.05)	1,797,125.94
1972.....	1,118,486.81	2,531,910.53	(1,413,423.72)	2,481,522.79
1973.....	777,938.48	2,814,679.23	(2,036,790.45)	1,346,929.23
1974.....	931,714.48	833,747.17	97,967.31	1,552,869.51
Total.....	21,824,261.74	35,035,660.77	(13,211,448.73)	33,214,923.11



Chart #1  
MARKET VALUE OF ASSETS OF BABCOCK FOUNDATION

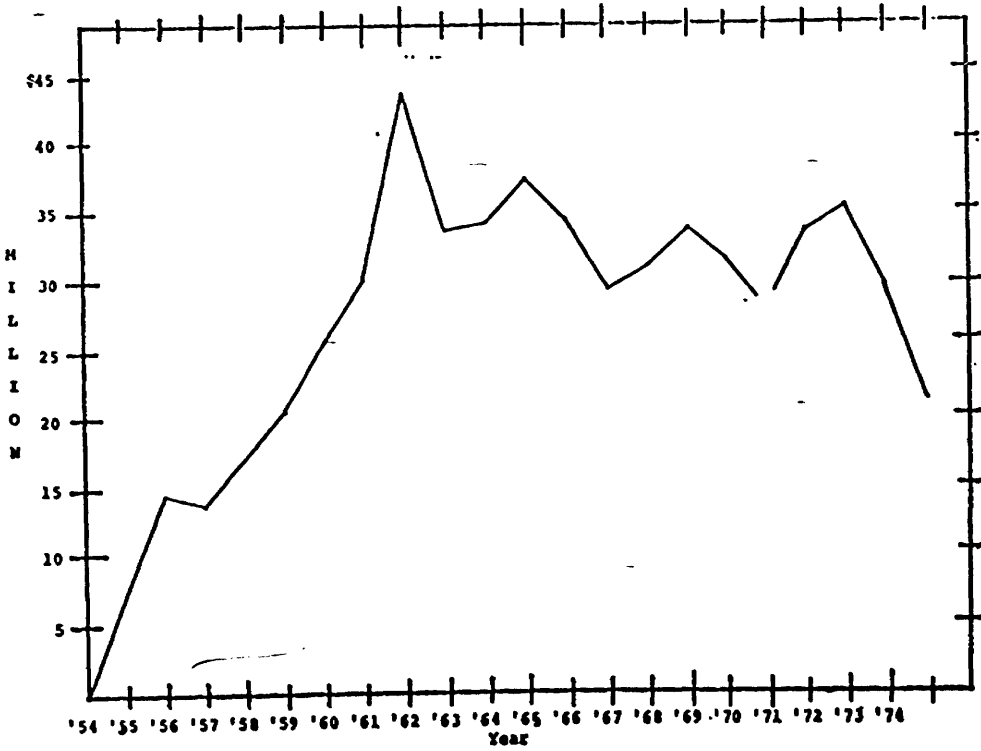


Chart #2  
GRANTS PAID & NET INCOME OF BABCOCK FOUNDATION

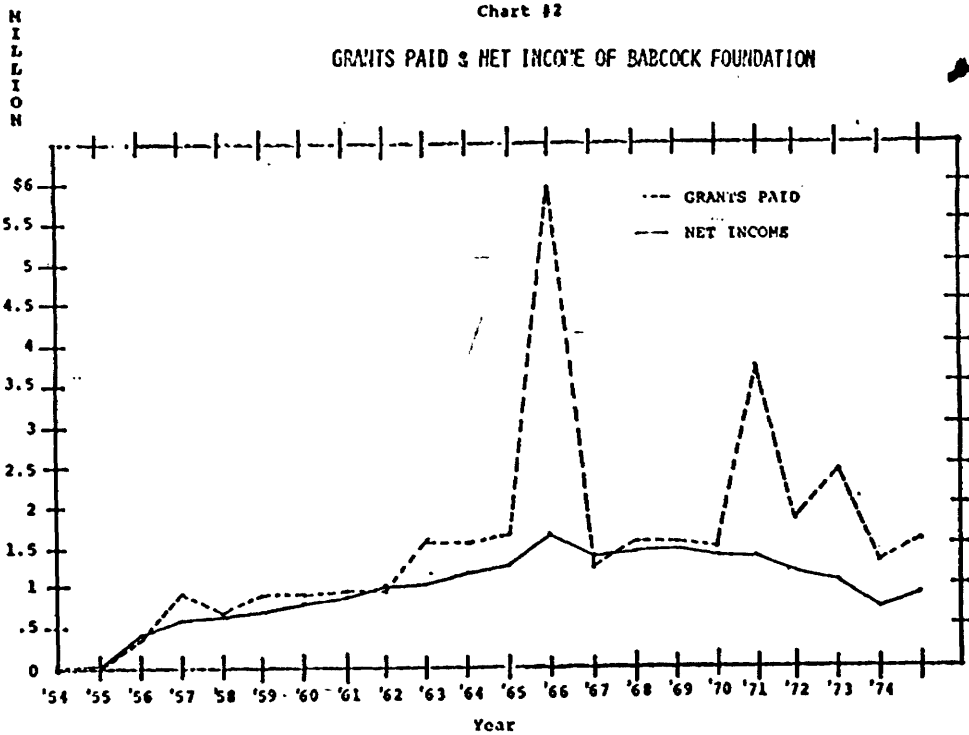


Chart #3

IMPACT  
OF  
PAST  
ECONOMIC  
CONDITIONS  
ON  
BABCOCK  
FOUNDATION

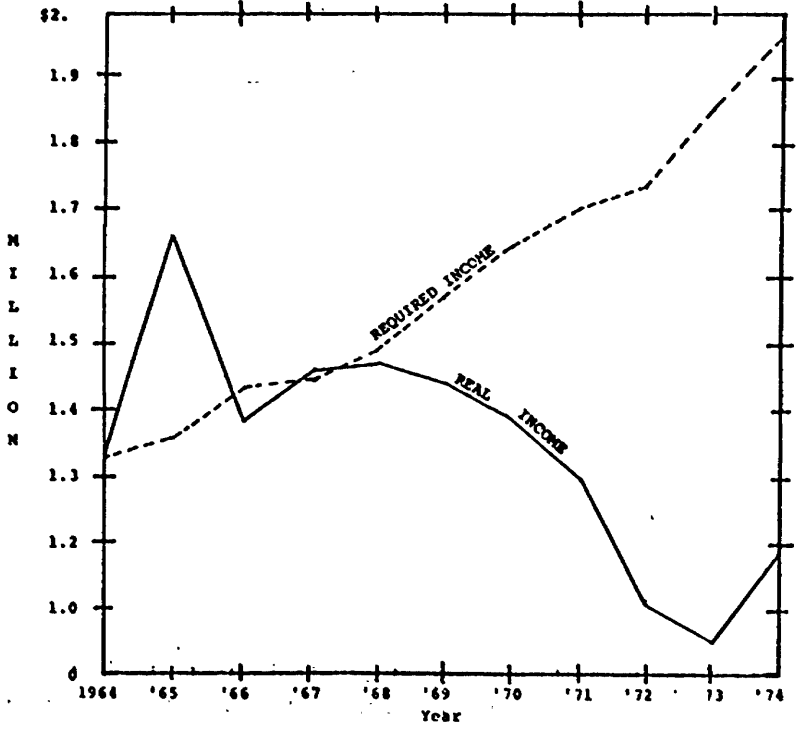
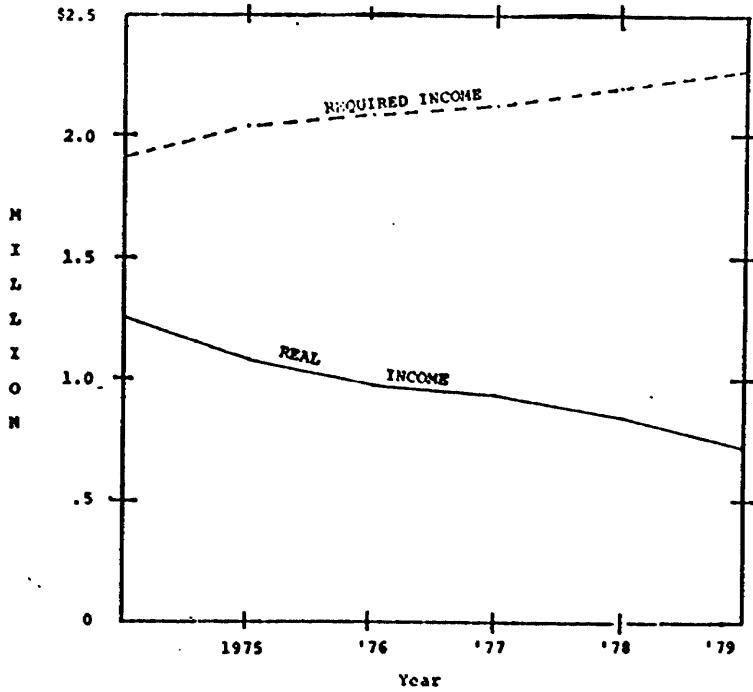


Chart #4

FUTURE  
IMPACT  
OF  
ECONOMIC  
CONDITIONS  
ON  
BABCOCK  
FOUNDATION



Mr. MARLOWE. Our next witness is Mr. Robert Augsburger, vice president for Business and Finance of Stanford University.

**STATEMENT OF ROBERT R. AUGSBURGER, VICE PRESIDENT FOR BUSINESS AND FINANCE, STANFORD UNIVERSITY**

Mr. AUGSBURGER. Mr. Marlowe, I believe you have my written testimony, and so in the interest of time I will just try to highlight a few of the facts set forth, and indulge in trying to emphasize a couple of the issues that I think are very critical from the point of view of Stanford, and I suspect that they apply more broadly and generally to other higher educational institutions as well.

Some 37 percent of Stanford's educational budget comes from private giving in the form of either current gifts or endowment income, from gifts previously received and invested. Foundations represent a very significant element of that gift giving. Over the last 10 years, 25 percent of our gifts have been received from foundations. Over the last 2½ years we have been engaged in a \$300 million fundraising campaign, and foundations have contributed close to 33 percent of the total of \$173 million that has been either pledged or given to date.

We have outlined in my memorandum to you some of the various sources of giving and the type of giving that we have received from foundations, but there is one very critical issue here that I would like to emphasize. Having come into higher education from the investment business about 4 years ago, I find it somewhat easy to draw analogies, and I think there is a very appropriate analogy here in that as I see it, foundations represent a source of venture capital for the social aspects of our society in the same way that venture capital firms represent a source of capital for the profitmaking segment of our society, and these both perform very valuable functions. They are generally staffed by knowledgeable, sophisticated people who are able to evaluate a variety of investment opportunities that are presented to them, and provide the seed money to get new ideas going. And those new ideas are beneficial to our society, whether they come out of the profit sector or out of the social, nonprofit sector.

And then it becomes the responsibility for that organization, whatever it may be, to find the permanent funding to proceed to develop more fully those ideas which are successful.

I have set forth one of them, and I would just like to elaborate on it because I think it is very important. Five years ago eight of our most senior faculty members from a variety of fields, recognized the need for a new course or a new curriculum that would interrelate biological and medical sciences with the social sciences, or particularly those of a behavioral character, anthropology, sociology, psychology and so forth. Through the auspices of the Ford Foundation we received a term grant for 5 years running about \$120,000 a year to begin to put together that program. This is the last year in which we have those term funds.

In the space of 4 years' time that program has become one of the most significant parts of Stanford's undergraduate curriculum. We graduated some 169 students last year with majors in human biology. It is now the third largest undergraduate major at Stanford University.

More importantly, these undergraduates are getting the opportunity to be exposed to people like Nobel Laureate Joshua Lederberg, to Paul Ehrlich, one of the most eminent population biologists in the country, to David Hamburg and Jane Goodall who have done pioneer work in the study of primates and the application of that knowledge to a better understanding of man.

Of those 169 graduates last June, about 25 percent are now in medical school, 5 percent are now in law school, and the others are scattered in a myriad of fields such as nursing, nutrition, agricultural food research and what have you. We probably could not have done that without the benefit of the kind of startup capital, if you will, that the Ford Foundation provided.

I could give you a number of other examples. This obviously is the most successful one, but it is very critical to us to have that kind of a source of funds, and all the more so as we face a greater and greater financial crunch, as one speaker this morning referred to it, in that we have to remain alive intellectually and programmatically to maintain our purpose.

The second issue I would like to discuss—and I am a little bit more comfortable with it because it is my background, has to do with the distribution rate or the payout rate and the analogy that it represents as far as Stanford's endowment is concerned.

As we have set forth in my written testimony, in measuring ourselves against a large group of other tax exempt investment funds, indications are that we have produced an above-average investment return over the last 5 or 6 years. Our funds have pretty consistently been in the top quartile of 2,500 tax-exempt funds that we measure ourselves against, yet during that period of time, our total return, dividends, interest, and change in capital value has been only 2 percent a year, our average total return.

At the same time we have been paying out for purposes of our operating budget something close to a 6-percent rate. About 3 years ago, even before the current decline in security prices we began to observe the fact that our income was not growing at the same rate that it had been growing, and this caused us to begin to try to understand the inter-related economics of our endowment and get a better handle on what was taking place here.

And the sum and substance of it is that we discovered that we were really spending at too high a rate, or distributing at too high a rate and not reinvesting enough in earnings to produce growth of income out into the future.

We are now in the process of cutting back on our endowment distributions, recognizing that there is a cost attached to that as far as the current generation is concerned, but that we do represent an institution for which we have a responsibility to preserve, and it is hopefully going to be around here for a good number of decades, and we have to be concerned about the future as well as we do the present.

In effect, we are assuming that most likely expected total return will be about 10 percent a year, and that our institutional increase in cost of living, if you will, or institutional inflation rate, is likely to be something on the order of 6 percent a year. This means that in order to maintain a growth of income consistent with growth of expenditures, that we need to get the endowment payout rate down to 4 percent.

I recognize that represents a somewhat lower figure than you have

been hearing in the last 2 days, and I would say that it is probably the more valid figure, that the others are being a little bit generous or a little bit circumspect or something, that 4 to 4½ percent is the more likely figure to sustain capital and program over a long period of time. The thing that I find sort of interesting is the fact that no one has commented about the source of income, and I really think that in considering either Internal Revenue regulations or legislation, that there ought to be a little bit more focus on your part on this.

As I understand the existing legislation, it is the greater of earned income or the set payout rate, and I think that that represents an artificial distinction, that earned income needs to be reinvested as well in order to maintain the purchasing power of investment assets.

It probably has not come to light here because most of the foundations have portfolios that consist of dividend paying stocks, simply where the income produced has not measured up to the set payout rate, but let us assume a foundation portfolio that has assets that are all in fixed income, and that the earned income and the total return, if you will, is 9 percent. If you pay out that 9 percent, which you are required to do under the present legislation, in some 20 years under an inflation rate as modest as 4 or 5 percent, you would have depleted the purchasing power of those assets by about 70 percent.

What we are doing at Stanford, and this is part of recognizing what was happening to our slowdown in endowment growth, is not distinguishing between earned income and appreciation. If we earned income, even though it is in excess of our payout rate, that amount that is in excess will be reinvested back in the endowment to produce greater income in succeeding years. I would suggest that somewhat more attention ought to be paid to that issue in regard to foundations. If one looks ahead at circumstances that are likely to exist because, you know, what it does is it sort of forces investment policy. It would force you to invest in issues that did not produce as much income currently in order to not exceed the payout rate, and perhaps that might not be the best investment decision or investment course.

Thank you.

Mr. MARLOWE. Thank you very much, Mr. Augsburger, especially for your persistence in being with us yesterday and today.

Are there any regulations in the State of California which govern your investment policies?

Mr. AUGSBURGER. We have a new Uniform Management of Institutional Funds Act which is in the process of being passed in other States. California did not follow the standard uniform act primarily because of concerns expressed by the State attorney general. We have a prudent man rule that is expanded to reflect the fact that educational institutions are operating kinds of institutions. The Uniform Act, on the other hand provides just a rule of standard business conduct. Ours is narrower in terms of investment alternatives.

Mr. MARLOWE. Do you think that you are at an advantage or disadvantage compared to foundations which operate under Federal rules regarding their investment policies?

Mr. AUGSBURGER. Well, I am not familiar with the rules in regard to investment policies, Mr. Marlowe, so I cannot really comment on that.

Mr. MARLOWE. You were talking about your payout rate being perhaps around 4 percent, projected.

Do you have any basis of comparing the portfolio which you have with the portfolio which either a foundation or foundations in general carry?

Mr. AUGSBURGER. Well, I suspect that ours is not too different from that of let us say the Ford Foundation or Carnegie Foundation, where there is not a significant holding of a single stock from the original donor. Our portfolio is a list of some 75 common stocks, and that represents in varying degrees 50 to 60 percent of the total.

We have, or happen to own a shopping center that is in the endowment portfolio that represents about 10 percent of the total, and the balance is in a variety of fixed income investments, almost all of which are marketable types.

So I suspect that it is, fairly comparable to those foundations that have been in existence for some period of time and have been through the process of diversification of investment assets.

Mr. MARLOWE. Good. Thank you very much.

Mr. AUGSBURGER. Thank you.

[The prepared statement of Mr. Augsburger follows:]

PREPARED TESTIMONY OF ROBERT R. AUGSBURGER, VICE PRESIDENT FOR BUSINESS AND FINANCE, STANFORD UNIVERSITY

In the current environment, all of us who have financial responsibility for private educational institutions have been forced to reevaluate the underlying economic forces which influence the financial stability of our institutions. In doing so, we recognize that we must be financially healthy to be academically healthy and, concurrently, we must be academically strong to remain financially strong. Achievement of these interrelated goals is dependent on our ability to innovate educationally and to maintain a stable base of support for established on-going programs. Since some 37% of Stanford University's educational budget is derived from private giving and endowment income, I intend to address some of the critical issues related to these sources of financial support.

In 1972, Stanford embarked upon a five year, \$300 million fund-raising campaign, at that time the largest such campaign of any independent educational institution. Our goals are to obtain \$125 million for endowment, \$92 million for term support and \$83 million for expansion of teaching and research facilities. To date, we have received gifts and pledges totalling \$173 million of which \$56 million or just about one third has been contributed by Foundations and Associations. These results are quite consistent with our history of gifts since during the past ten years foundations have provided 25% or \$78 million of our private contributions, and associations some \$9 million or 3% of the total. Thus, as private support of Stanford has grown, so has foundation support grown in a fairly proportionate pattern.

It has been our experience that foundations tend to provide term support for projects such as research and educational experimentation and development, and also support for physical facilities. They are less inclined to provide permanent funding through gifts to endowment. These practices were anticipated in planning for the Campaign for Stanford and it is interesting to note how they are reflected in the results to date:

Purpose	Amount from foundations and associations	Percent	Target percent in campaign for Stanford
Term.....	\$33,500,000	60	31
Plant.....	17,600,000	31	28
Endowment.....	5,300,000	9	41

During the Campaign, Foundations have been involved in the establishment of twelve professorial chairs, in a variety of fields:

Ford Foundation—International Studies; Human Biology.  
 Baxter Foundation—Pharmacology.  
 Irwin Foundation—Cardiology.  
 1907 Foundation—Civil Engineering.  
 W. R. Kenan Trust—Undergraduate Studies.  
 Avalon Foundation—Humanities.  
 Kresge Foundation—Marketing.

We have also been most fortunate in receiving foundation assistance toward the construction of new buildings for which the University has a high priority need. Among these have been a \$7.5 million gift from the Fairchild Foundation for a neuroscience facility in our School of Medicine; a \$1 million gift from the Kresge Foundation for our new law building; and a most recent gift of \$2.5 million by the Seeley G. Mudd Fund toward a greatly-needed chemistry building.

More important than the sheer numbers, perhaps, is the fact that foundations represent sophisticated, discriminating donors. They understand what the educational process is all about; they have the ability to differentiate between truly significant educational progress and that which simply reinvents the wheel; they have the ability to encourage experimentation which is essential to learning; and they provide a discipline, requiring evaluation and accountability. Let me outline a couple of examples of the extent to which foundation support is enabling Stanford to provide educational vitality. The first of these is our program in Human Biology. Started just four years ago, with financial support from the Ford Foundation, this program was created in response to the need for knowledge of the complex relationship of man and nature. Its originators were eight of our most distinguished senior faculty from the biological sciences, from the medical sciences and from the social sciences. Within the space of a single student generation, Human Biology has become the third largest undergraduate major in the University—perhaps the most dramatic growth ever experienced by a new curriculum in a major institution. Last June, almost ten percent of our baccalaureate degrees were awarded in Human Biology. In addition to initial term support, the Ford Foundation provided endowment for four half-chairs, and matching funds for three of these have now been secured. The incumbents of all three chairs are senior members of the Stanford faculty who have been teaching in the program, but who will now be able to devote their full undergraduate teaching commitment to it into the future, guaranteeing a cadre of academic leadership for the program after the present Ford term grant expires.

A more recent example is an experiment in structured liberal education for the freshman year at Stanford, begun last year under a grant from the Carnegie Corporation. It involves a small group of specially selected students, living in the same residence hall and participating in a common core curriculum emphasizing the traditional major divisions of knowledge: the natural sciences, the social sciences, and the humanities. The materials are not studied as separate fields but as a coherent body of knowledge produced during three important periods of Western culture—the Greeks, the Renaissance, and the Modern. The impact of such a program on the undergraduate curriculum at Stanford remains to be tested, but the risk capital provided by foundations, such as Carnegie, is essential to education experimentation and such experimentation is essential to the intellectual growth and vitality of undergraduate education.

I have tried anecdotally to convey to you the importance of foundation support to Stanford. Since this is a legislative hearing dealing with legislation affecting foundations, I would be remiss if I did not comment on what we perceive to be an inequity in existing legislation—i.e., the four percent tax on foundation investment income. Since foundations support tax-exempt institutions, any tax levied simply reduces the amount of grant money available to places like Stanford. The effect is no different than if you were to place a tax on us on the basis of gifts-received. Furthermore, we know of no other tax which is levied essentially to pay for the costs of administration. We recognize that there may be foundations whose principal objective is tax avoidance. However, our experience indicates that most have genuine, sincere program objectives whose intent is to provide support for non-profit, tax-exempt institutions. We question the equity of penalizing them, and consequently us, for the improper motives of a few.

Let me turn now to the issues related to endowment management and income utilization.

Stanford University's endowment at August 31, 1974 approximated \$325 million. Of this, nearly \$100 million represents a variety of assets in a variety of forms over which the University has little immediate management control. The balance of \$225 million consists principally of marketable securities held in two pooled accounts and supervised by the Investment Committee of the Board of Trustees. It is to these assets and the income they produce that my remarks will be directed.

#### ENDOWMENT ASSET MANAGEMENT

Stanford's endowment has historically been invested in a diversified list of common stocks and bonds of varying maturities. We have invested these assets for total return, i.e., a combination of income and growth of principal value. We attempt to maintain a proper balance in the preservation and enhancement of the purchasing power of endowment principal and in the current income from endowment. The amount invested in common stocks has fluctuated between 50% and 60% of the total. In modest proportions, efforts are made to adjust the asset composition on the basis of perceived opportunities and risks in the prevailing economic and securities market environments. These moves, however, are generally at the margin, since we consider ourselves as essentially long term investors.

#### ENDOWMENT INVESTMENT RETURNS

Each calendar year we attempt to compare our investment results against a universe of some 2,500 endowment, pension, profit-sharing, foundations and other tax-exempt funds. Data available for the five calendar years through 1973 indicates that Stanford's endowment returns have been in the top quartile of all the funds measured. In spite of this well-above-average performance, our total annual return for this five-year period has been only about four percent.

The decline in security prices over the past ten months has quite obviously had a significant impact on our returns. For the six fiscal years through August 31, 1974, we have experienced an average annual total return of less than 2%.

#### ENDOWMENT INCOME DISTRIBUTION

The distribution of income from endowment is determined by two limiting factors: (1) the terms of the gift from the donor, and (2) policies adopted by the Board of Trustees. Where the terms of the gift restrict income to dividends and interest, it has been our practice to distribute all such earned income each year. Over the past six years this has fluctuated between 5½% and 6½% of beginning market value. Where the terms of the gift or the nature of the funds permit the expenditure of principal, it has been our practice to distribute both earned income and appreciation (realized or unrealized) at a rate equal to that earned in the other funds. With the severe decline in security prices this past year, our unrealized appreciation very quickly disappeared, and it became necessary to suspend distribution of that portion of endowment income budgeted from appreciation. This action resulted in a \$2.5 million income shortfall last year—a shortfall which had to be absorbed by reduced spending and/or consumption of reserves. In the absence of a dramatic turnabout in security prices, a similar situation will prevail during this current year.

#### ENDOWMENT PAYOUT ISSUES

Events of the past year forced us to accelerate studies then underway which were directed toward an improved understanding of the economics of our endowment and the role which it plays in University finances. (Interestingly enough, these studies are being financed by a small grant from the Lilly Foundation.) The objectives derived from these studies are:

1. To make investment management independent of University spending decisions.
2. To develop a spending rule (rate of endowment payout) that protects the real value of endowment principal.
3. To create spendable endowment income which is reasonably stable and predictable from year to year and which increases at a rate commensurate with that of expenditures.

It has become increasingly clear to us that none of these objectives are now being achieved. You will recall that our total return over the past six years has averaged less than 2% annually while our payout has been approximately



6% each year. Because we have been spending or distributing at a rate greater than that earned (on a total return basis), the real value of the endowment principal is being eroded, not only by inflation, but also by spending. The lack of reinvestment has stagnated growth in endowment earnings, eliminating the growth element which is necessary to offset, at least partially, increased costs of University operations. Simply put, it is our conclusion that to have our endowment in economic equilibrium the difference between the total return and the payout rate must approximate the institutional inflation rate. If we assume a long term total return of 10% and an institutional inflation rate of 6%, then we must get our endowment payout rate down to 4%. I might add that is exactly what we are in the process of doing.

What is important to recognize in this analysis is that *it is the spending rate, not the form of income, that is critical*. Even though we might earn dividend and interest income of say 7 to 8 percent, that amount in excess of 4% (or whatever spending rate is determined) must be reinvested to maintain the real value of the principal.

It appears to us that there is a substantial analogy between our own endowment economics and that of the foundations. In macro-sense, the investment assets of the foundations are clearly an extension of the endowments of the institutions they support. To the extent that they are required to pay out at a rate which does not reflect the difference between expected total return and the inflationary rate of the institutions they support, their principal will ultimately be eroded and they will cease to be a source of financial support—a condition which would be devastating to their donees, such as Stanford.

For the reasons, I question the wisdom of the requirements of the present legislation which make it mandatory to pay out all earned dividend and interest income if that amount is greater than the established payout standards. I also question the basis on which the payout standard is being determined by the Secretary of the Treasury in that it does not now appear to reflect an appropriate balance between the present and the future.

Just as we at Stanford University are taking steps to reduce the level of our payout rate to protect future sources of endowment income, we believe that greater attention need be paid to Foundation payout rates as it is in our interest to see that those future sources of income are protected as well.

Mr. MARLOWE. The last witness today is Mr. George White of the Eugene O'Neill Center.

#### STATEMENT OF GEORGE WHITE, THE O'NEILL CENTER

Mr. WHITE. Thank you, Mr. Marlowe. It is a great pleasure to be here and a privilege. I have submitted a statement and would like to touch on a few items therein.

My name is George White. I am President of the Eugene O'Neil Memorial Theater Center, which is the home of the National Playwrights Conference, the National Theatre of the Deaf, the National Theatre Institute, and the Critics Institute and their allied programs.

It is terrifying to contemplate the possible results of the diminution of foundation giving, particularly in the performing arts, the foundation funding due to shrinking portfolios has already begun to have an effect on major funds. In contemplating the reordering of their priorities, the arts often are, someone once termed "the last hired and the first fired."

I think it is important to emphasize that I do not think we are crying wolf when we say that the possibility of the collapse of major arts organizations could result in throwing thousands of people out of work. In southeastern Connecticut alone, the area in which we operate—we have New York offices—benefits in excess of \$1 million a year due directly to foundation funding. I think this also puts undue pressure on the National Endowment and the state arts councils for this to

happen. And I also think the only other alternatives to foundation giving are corporate or individual gifts, and I find that individual gifts have lessened in the last few years and I also feel that corporate giving is a few years away. The prime users of the performing arts to which we really are a research and development arm of the entertainment industry, is very notoriously cynical in their attitude toward helping the performing arts.

And last, I would like to say that I was sent out to Australia two years by the State Department and have been in a lot of other countries around the world and find that we as a Nation are the leaders in private philanthropy, and we really are viewed with a great deal of awe and admiration by artists in other countries.

Indeed, I think foundations should serve as a model for people in the arts and Government of how to dispense large sums for maximum impact at minimal administrative costs. It is my hope that in the future ways will be found to implement this service to our free society.

**Mr. MARLOWE.** Thank you. About how much of your support comes from foundations?

**Mr. WHITE.** About 75 percent.

**Mr. MARLOWE.** From a mix of foundations?

**Mr. WHITE.** Yes, local and the big national ones, from the Rockefeller Foundation, Ford Foundation, to the small ones.

**Mr. MARLOWE.** Have you noticed a decline coming from foundation support?

**Mr. WHITE.** Well, I am luckily at the moment on a 5-year grant, what is termed a terminal grant from the Rockefeller Foundation. It is a frightening term. So that we are now at the point where we are coming down to it in 2 or 3 years. I do know of a very strong reordering of priorities and a lot of people are very, very nervous about the fact that the arts are going to suffer now.

I have not been to a foundation recently that has turned us down in the last 6 months because of this, but I know I am going to run into this very, very shortly, and I spend my life—

**Mr. MARLOWE.** What sort of activities is your center involved with?

**Mr. WHITE.** Well, it is primarily in the developmental research sides of the performing arts. We have the National Playwright Conference, which has presented over 100 plays by new playwrights in the last 10 years. And we have the National Theater for the Deaf, which was an interesting idea. It was a nice combination of Government and private foundations working together. It was primarily funded by the vocational rehabilitation arm of HEW, along with private foundations working on a 50-50 basis. And now that is pretty much on its own. And we also train students from 62 different colleges and universities in the performing arts, so we have a rather multifaceted program that allows us to receive from different foundations different kinds of grants, both in the area of the handicapped and of the area of education and administrative arts.

**Mr. MARLOWE.** And in the field perhaps of getting the arts out to new groups of people who perhaps have not been exposed to art, theater. The Senator asked Ms. Hanks this morning what the National Endowment was doing in the area of core-city, inner-city area.

Has that been anything that you have been involved in at all?

Mr. WHITE. We are very deeply involved in that. First of all, the Theater of the Deaf itself is a major, we undertake it as an artistic venture but it, of course, is a major sense of pride to the handicapped because this is something that is not for the deaf; it is of the deaf. It is something that deaf people can do better than hearing people, not something as well or almost as well.

It has become a source of pride to all of the handicapped and it has done a great deal in the psychology of the handicapped nationally.

We are also in a program of training teachers to use dramatic techniques, the techniques of the theater, to be better teachers of history, of geography, and of course the example often used, it is in a classroom where teaching kids the Civil War, you divide the class into the North and the South and you argue the battles and the issues that way, which is a straight, old-fashioned theatrical technique that is taught to actors in every acting school in the country. And those kind of techniques applied to education are very important.

We have found also in the inner-city systems of being able to have groups that are under, that are having problems in the inner-city to be able to act out aggressions on stage rather than in the streets.

We have been effective in coming up with programs this way, a direct, practical application of art forms we found to be very important and very useful and this has been done due to the kind of enlightened funding that has come from foundations which has allowed us to do this.

Mr. MARLOWE. Let me ask you a leading question. Do you find enough foundation interest in the type of programs that you are doing?

Mr. WHITE. Do I find enough?

Mr. MARLOWE. Yes.

Mr. WHITE. Yes. Actually, I have always found foundations really leading in that area tremendously. They have been wonderful.

Mr. MARLOWE. I would assume you would like them to do more.

Mr. WHITE. I certainly would. I am terrified they are going to do less.

Mr. MARLOWE. I think that is a problem because what you have described has been innovative, experimental, yes, but not in the sense of being a fly-by-night experiment. Innovative in that sense, really. And I gather that you are suggesting that this type of innovation obviously would be in jeopardy if foundations are so adversely affected by the economic conditions and/or by the Tax Act provisions that they were forced to cut back.

Mr. WHITE. I found this and if I may, I know this is one of the advantages and disadvantages of being the last, I guess, is the time factor, but the things that I have noticed, of which I think is due probably to the 1969 Tax Act, too, something that has concerned me along this line, and that is in the area of individual grants, because sometimes it comes down to people, individual people, doing this and I have noted, although I think foundations are very loathe to give individual grants any more since 1969, and I cannot quote the reason for it but I know they are very loathe to do this for a lot of witnesses have gone into this. But I know of artists who have been working in the experimental areas and by that experimental has come to mean something far out. I do not mean that but I mean really working like

scientists—have noticed an enormous drop since 1969 in just personal grants.

And I guess perhaps off the subject but involved with that 1969 Tax Act I find it inequitable to artists who can paint a painting, for instance, and if they give it to a museum—and we have a museum and library connected with the center—they paint a painting and give it to us, as I understand the Act and as they do, they get a deduction for the amount it cost them for the paint and the canvas. Or as somebody else, a private individual can come and buy that painting for \$5,000 and donate it and get the full deduction. I think there is a short circuit there somewhere in the equity of that.

I find that whole business of gifts—and I know there have been abuses about private papers and all of this kind of thing—but it is hurting us in terms of getting donations for libraries, for things like that. There is a certain amount of throwing out the baby with the bath there.

Mr. MARLOWE. Two points that you made there. I believe that the Council on Foundations has addressed itself in its submission to the Filer Commission to the question of the impact which the tax Act has had on grants to individuals, and there is no doubt that there was some abuse taking place prior to 1970, but there is, I suggest, at least a possibility that there was some legislative overkill also, which I think is what you are referring to.

On your second point that interested me, on tax provisions that affect artists. I think there is some legislation pending before Congress, on that subject, I believe.

I have no idea what progress, but I think that this is an area which I know that Senator Hartke has indicated an interest in pursuing next year as one of the program areas. And we may approach it from the standpoint of foundation involvement in the arts, but I would trust that we would also get some testimony on the problems which artists have under the current tax laws because there apparently is some inequity which at least ought to be examined to determine whether the tax provisions are adequate, inadequate, just or unjust.

Mr. WHITE. I would be very anxious and willing to help in any way I can to talk to that point because there are many problems in it, right down to the small actor who is taxed, for instance, just on a withholding basis for one rolé he does on television on the basis of what that would mean if he got that salary all year long, and therefore, he really nets out very, very little, and the artist who cannot really make a contribution.

And we had a recent donation of a gift by a major set designed for a rendering which I know sells for \$3,000 to \$4,000. And we literally had to give him a certificate, a receipt for the appraisal of \$1.25, which was the exact amount of that paper. And I think that that could be argued that it was only worth 85 cents, and that somehow it really hurts because here is an artist making a contribution and he is hurting.

Mr. MARLOWE. Thank you very much.

Mr. WHITE. Thank you sir.

Mr. MARLOWE. Our hearings will be recessed, subject to the call of the Chair.

[The prepared statement of Mr. White follows:]

PREPARED STATEMENT BY GEORGE O. WHITE, PRESIDENT, EUGENE  
O'NEILL MEMORIAL THEATER CENTER

It is an honor and privilege to have the opportunity to address the vital subject of Foundations before this committee. I do so because the Eugene O'Neill Memorial Theater Center has benefited greatly from Foundation largesse and continues to rely heavily upon it for its very existence.

It is terrifying to contemplate the implications of the threatened major cut-backs in foundation giving, particularly to organizations which were established and grew during the past decade; a time which could well be termed the "golden age of foundation giving" for the performing arts.

Reduced foundation funding, due to shrinking portfolios and inflation, has forced many major funds to contemplate or actually reorder their priorities to the detriment of the very arts organizations they played a major role in spawning.

The ultimate result of this trend must per force place undue pressure on the already overburdened National Endowment and State Arts Commissions. We in the arts are faced with the bleak prospect that many organizations will collapse, causing thousands to be thrown out of work, and creating economic hardship for the many businesses and services which have come to depend for a major portion of their revenue on arts organizations. (Southeastern Connecticut alone benefits in excess of one-million dollars annually, due directly to the O'Neill Center's foundation funding).

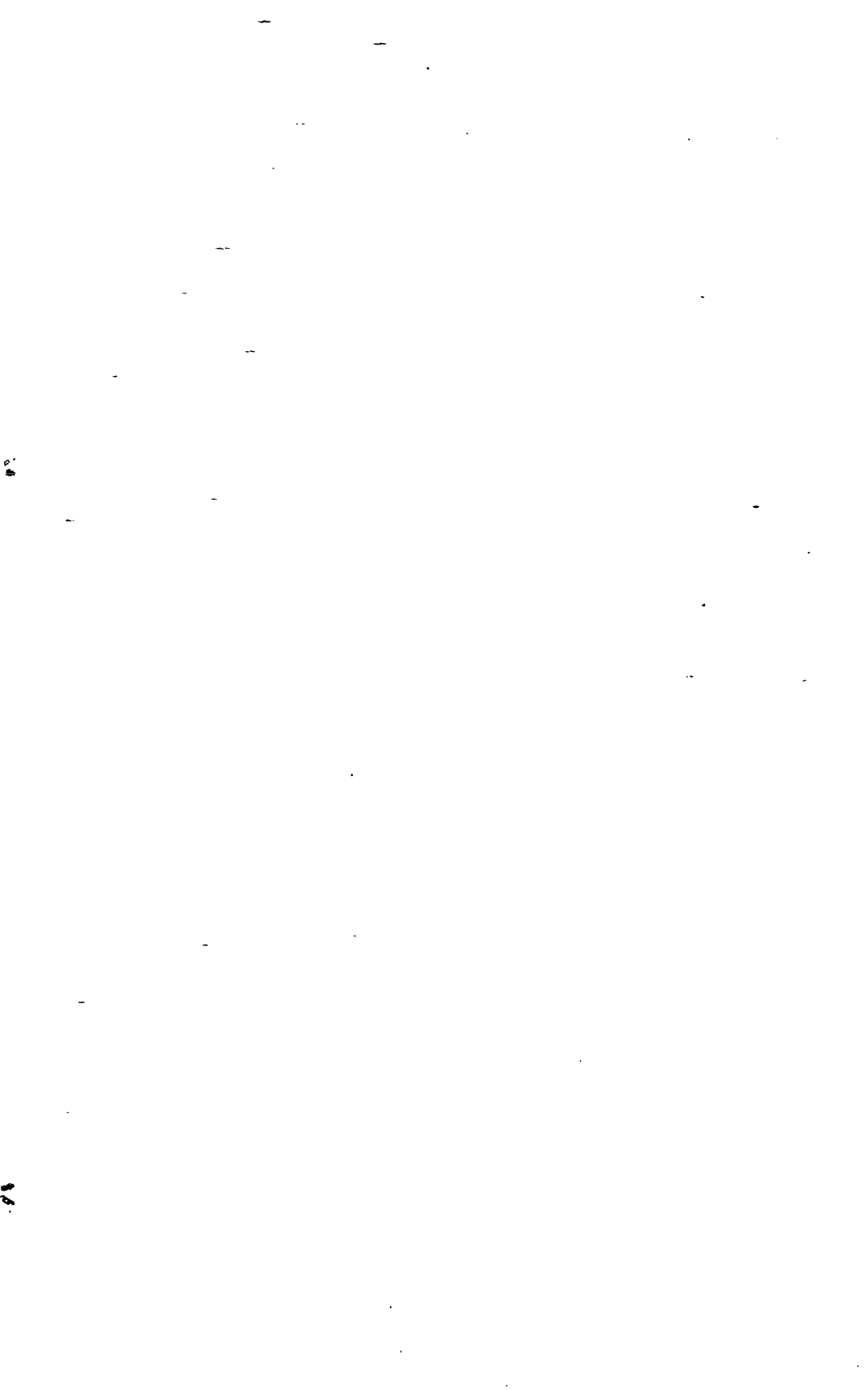
Alternative sources to government or foundation grants are, of course, individual and corporate gifts, which in the former instance, seem to have lessened (particularly in the area of gifts in kind, due to the 1969 tax reform act) and in the latter case, corporate giving (with a few notable exceptions) is in its infancy and seems that a meaningful impact from this source is years away. Indeed, the very industry that benefits directly from the non-profit arts institutions i.e. the entertainment industry is notoriously cynical in their attitude toward support.

From the admittedly parochial viewpoint of a recipient, I can only hope that foundations be given the tools to continue their support of the arts. Though I'm sure the 1969 tax reform act corrected many abuses, I also have found that to some extent the "baby was thrown out with the bath." Many important gifts "in kind" such as works of art by artists and donations of other kinds to museums and libraries were lost. Individuals rarely benefit any longer from foundation grants. With the exception of The Guggenheim Foundation, foundations since 1969 are very weary of grants to individuals and many artists have suffered because of this.

I have traveled to many foreign countries and have noted with pride, the awe and admiration reserved for American private philanthropy. Truly, we are world leaders in this field and the vitality of our arts and sciences reflect this. Indeed, foundations could well serve as models of good fiscal management to us all, dispensing large sums for maximum impact at minimal administrative expense. It is my hope that further ways may be found to implement their essential service to our free society.

Thank you.

[Whereupon, at 2:55 p.m., the subcommittee recessed, to reconvene subject to the call of the Chair.]



---

---

**Appendix A**

---

**Communications Received by the Committee Expressing an  
Interest in These Hearings**

---

---





**SUMMARY OF THE PRINCIPAL POINTS OF NANCY M. GLASGOW, PRESIDENT,  
THE NATIONAL ASSOCIATION OF FOUNDATIONS, INC.**

1. The National Association of Foundations, Inc. is firmly opposed to the Bill H.R. 5729 introduced by Chairman Wright Patman, D. of Texas, Chairman of the House Banking and Currency Committee.

2. The present crisis faced by Private Donor Foundations and all those who invested in the stock market and the various stock exchanges would be much worse if the Dean of the House of Representatives has his way! Chairman Patman is also Chairman of the Joint Economic Committee of the Congress and Chairman of the Subcommittee on Domestic Finance of the Banking and Currency Committee.

3. The importance of retaining the family foundation and the family business. Remember, the large foundations are very few in number. It is the family foundations who are the majority of the Private Donor Foundation Movement.

4. The vital importance of the Private Donor Foundation is being demonstrated in the present financial crisis. They stand as a bulwark against Communism and as a pillar of the economy.

5. The great hope of the future is the power placed in the Private Donor Foundations to act independently of all outside influences.

6. The existence of dedicated private individuals of wealth is the one hope of the world in planning and combating the vast problems which cannot be undertaken by government alone. The most advanced thought and planning for the survival of mankind will come from this area.

Mr. Chairman, and distinguished Members of the Senate Finance Committee, Subcommittee on Foundations, it is a great privilege for me to have the opportunity of presenting the position of The National Association of Foundations, Inc. before you on such a momentous occasion. I wish to speak to the heart of the subject before us the tremendous losses of the large Private Donor Foundations which have huge diversified stock and bond portfolios invested in the various stock exchanges and markets. For some time, The National Association of Foundations, Inc. has had the sole responsibility for combating the forces within the financial community who constantly pressure the Private Donor Foundations to sell the substantial holdings they have in many family businesses and closely held corporations and invest the accumulated wealth of the Anglo-Saxon establishment in the unprotected and highly volatile stock market. All this is done under the guise of helping charity. Who is being helped when large foundations must cut their grants in half?

The Dean of the House of Representatives, Hon. Wright Patman, D. of Texas, Chairman of the Banking and Currency Committee of the House and former Chairman of the Small Business Committee and Chairman of the Subcommittee No. 1 of that Committee, has for a long time enjoyed total jurisdiction over the Private Donor Foundation Movement of the United States. Chairman Patman, for many years, has taken great pleasure in pressuring Private Donor Foundations to sell their hard earned interests in all family businesses and to invest the money in diversified stock portfolios. The present crisis serves only one purpose which is beneficial to Private Donor Foundations it shows the fallacy of Chairman Patman's thinking. Remember, Gentlemen, Chairman Patman is also Chairman of the Joint Economic Committee of the Congress as well as being Chairman of the Subcommittee on Domestic Finance of the Banking and Currency Committee of the House of Representatives.

On March 15, 1973 Chairman Patman introduced in the House of Representatives a Bill H.R. 5729 which was referred to the Committee on Ways and Means of the House of Representatives. The purpose of this Bill was to force the diversification of the holdings of all Private Donor Foundations incorporated within the United States of America. I am attaching a copy of H.R. 5729 to be placed in the record of this hearing. No Private Donor Foundation would be permitted to have more than ten percent of its stock in any one taxable entity.

In other words, diversify or be fined! The effect would be to dump unknown quantities of stock on an already glutted stock market forcing huge losses to the parent companies and depriving the recipients of foundation grants, whom the Chairman claims to be helping, of any financial support whatever.

Most major corporations in America have a foundation if all the stock of all these companies were dumped on the open market within 180 days after the enactment of H.R. 5729 I wonder how long the nation would survive. Remember, Gentlemen, all this would be done in the name of progress as Chairman Wright Patman is Chairman of the Committee on Economic Progress!

I respectfully request the following material be inserted in the official record of these hearings: The text of H.R. 5729; Statement of Chairman Patman before the Committee on Ways and Means, Wednesday, April 18, 1973; Statement of Chairman Wright Patman's Committee Office—An Opposing View: Facts Omitted By The Foundations In Their Argument For A Lowering Of The Minimum Distribution Requirement; Membership Bulletin of The National Association of Foundations, Inc., Vol. II, No. 33, June 8, 1973; Statement of Mrs. Nancy M. Glasgow, President, The National Association of Foundations, Inc. on H.R. 5729 Introduced Before The Committee On Ways And Means Of The House Of Representatives During The Hearings On The Tax Simplification Act.

What Private Donor Foundations are experiencing is part of a world wide situation, we are in a very serious crisis. I wish to add a new dimension to your thinking, count the number of governments that have fallen since the comet came in November of 1973. Part of our problem is human and part is beyond us. We are in a new world order and we must learn to cope with it. I sincerely urge you distinguished gentlemen to pray for divine guidance.

(H.R. 5729, 93d Cong., 1st sess.)

A BILL To amend the Internal Revenue Code of 1954 to require private foundations to diversify their holdings

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4944 of the Internal Revenue Code of 1954 (relating to taxes on investment which jeopardize charitable purpose) is amended by adding at the end thereof the following new subsection:*

**"(f) FAILURE TO DIVERSIFY PORTFOLIO.**

**"(1) TREATED AS JEOPARDIZING CHARITABLE PURPOSE.**—For purposes of this section, on each day on which a private foundation fails to dispose of any nondiversified holding such foundation shall be treated as making an investment, in an amount equal to the amount of such nondiversified holding, in such a manner as to jeopardize the carrying out of its charitable purposes.

**"(2) NONDIVERSIFIED HOLDING DEFINED.**—For purposes of this subsection, the term 'nondiversified holding' means the amount (if any) by which the value of the private foundation's holdings of stock and debt obligations of any corporation exceed 10 percent of the value of the total assets of the private foundation.

**"(3) DETERMINATION DATE.**—For purposes of this section, the amount of the nondiversified holding of a private foundation in any corporation for any period shall be determined—

**"(A)** in the case of the taxes imposed by subsection (a) for any year (or part thereof), on the day in the year (or part thereof) on which the amount of the nondiversified holding was the greatest, or

**"(B)** in the case of the taxes imposed by subsection (b), on the day in the correction period on which the amount of the nondiversified holding was the greatest.

**"(4) SHORT-TERM NONDIVERSIFICATION TO BE DISREGARDED.**—Paragraph (1) of this subsection shall not apply to the holdings of any private foundation in any corporation until such foundation has had nondiversified holdings in such corporation on each of at least 180 days occurring after the date of the enactment of this subsection.

**"(5) 5-YEAR PERIOD TO DISPOSE OF PRESENT HOLDINGS.**—This subsection shall not apply to stock and debt obligations held by the private foundation on March 1, 1973, until the date which is 5 years after the date of the enactment of this subsection.

**"(6) 5-YEAR PERIOD TO DISPOSE OF GIFTS, BEQUESTS, ETC.**—If, after March 1, 1973, there is an increase in the holdings of stock and debt obligations (other

than by purchase by the private foundation) held by a private foundation, this subsection shall not apply to the stock and debt obligations representing such increase until the expiration of 5 years after the later of—

“(A) the date of the enactment of this subsection, or

“(B) the date on which such increase in holdings occurs.

“(7) CONTROLLED GROUP OF CORPORATIONS TREATED AS ONE CORPORATION.—For purposes of this subsection, all corporations which are component members of the same controlled group of corporations (within the meaning of section 1563) shall be treated as one corporation.”

#### STATEMENT OF CHAIRMAN PATMAN

Mr. Chairman and members of the committee: I appreciate your invitation to testify before this committee on the important subject of tax exempt private foundations. A little over four years ago you extended a similar invitation to me and as a result of those deliberations the Tax Reform Act of 1969 vigorously addressed itself to the serious abuses I documented at that time.

The Tax Reform Act of 1969 established the standards that those who desired reform of private foundations had been seeking for many years. The provisions that pertain to the excise tax on private foundations, self dealing, the minimum payout requirement, excess business holdings, jeopardy investments and the prohibition of political activity were the result of many years of study by Subcommittee Number One of the Select Committee on Small Business, the 1965 Treasury Department Report on Private Foundations, and many months of serious deliberation by the Committee on Ways and Means and the Committee on Finance.

Since the passage of the Tax Reform Act of 1969 the Department of Treasury and the Internal Revenue Service have attempted to implement your legislative intentions by the promulgation of temporary and final regulations that in most instances have been in effect less than a year. For this reason I believe that two decades of investigation and study, a year of legislation, four years of implementation of regulations and less than a year compliance should not be answered by a lessening of the provisions that are of primary importance in the supervision and regulation of private foundations. I believe that the response of the foundation community should not be that of an attack on the work of those who sought reform and performed the difficult task of legislating that reform. Those who are truly concerned with philanthropy could better achieve the results envisioned by those who advocated the government subsidy of charitable donations by directing their efforts at the elements of their community which continually promotes their personal well-being under the guise of philanthropy.

If Congress is to justify a deduction that primarily benefits the upper and upper-middle bracket taxpayer it must assure itself and the public it serves, that the results of this tax privilege are annually passed on to its intended beneficiaries. These beneficiaries must reflect something other than a narrow constituency of male, urban and corporate executives who are the present reigning officers and trustees of the majority of private foundations.

Contrary to many of the leaders and spokesmen for the foundation community who advocate major and substantive revision of the work your committee accomplished in 1969, I have come here today to urge you to holdfast against an attack on good work achieved by the Tax Reform Act of 1969. The legislation that I will discuss this afternoon is in the form of a refinement of the existing provisions and is intended to improve upon, not detract from, the standards achieved in 1969.

These provisions were not arrived at through a concern for the perpetuation of self, but are the result of studies and hearings held by the Subcommittee on Domestic Finance of the Committee on Banking and Currency. These provisions are something more than pleas of those who find compliance a challenge to their definition of philanthropy. The provisions that I present to you today are concerned with the protection of the “public trust” which your committee has decided to warrant a deduction upon creation, and exemption for its duration.

H.R. 5728

The first provision amends Section 4940 of the Internal Revenue Code, which imposes an excise tax of 4 percent on every private foundation's net investment income. The provision I have introduced, H.R. 5728, would specifically

earmark the revenues generated by the excise tax on the net investment income of private foundations for the auditing and supervisory purpose for which it was intended. Currently the revenues generated by the excise tax on private foundations are commingled with the general revenues of the Treasury and are not earmarked, segregated and made available for the specific purpose which the legislative history of Section 4940 addresses itself to. While the specific earmarking of the revenues generated by Section 4940 is an important refinement, the most important recommendation of H.R. 5728 is the mandatory sharing of the revenues of this excise tax with the states.

Historically the Attorneys General of the states have been charged with the responsibility to represent the interests of the beneficiaries of charitable dispositions. The Congress, in its wisdom, has never attempted to impose upon the Internal Revenue Service, its revenue-collecting agent, the daily supervision of charitable trusts and charitable corporations.

On April 5 and April 6 the Subcommittee on Domestic Finance of the Banking and Currency Committee heard testimony pertaining to the functions of the states in the regulation and supervision of private foundations. Some of those who agreed with the fact that the states possessed the aforementioned powers which the Internal Revenue Service did not and, further, agreed that the states have a necessary and proper role in the supervision of private foundations were Dr. Robert F. Goheen, Chairman of the Council on Foundations; Mr. Lee Henkel, Chief Counsel of the Internal Revenue Service; and the Attorneys General or representatives from the States of New York, California, Illinois, Massachusetts, and Ohio.

H.R. 5728 is an answer to the problem that has been unanimously expressed by the state officials charged with the responsibility to regulate and supervise entities created for the charitable beneficiary. By making available to each state a minimum of \$250,000.00 the state officials will no longer have to make that difficult choice between the fighting of a rising rate of crime or the protection of the states' charitable beneficiaries.

I find it difficult to understand how the leading spokesmen for the foundation community can continuously attack a proposal that seeks to achieve a true balance between the federal and state supervision of charitable "public trusts." It is difficult to understand how the spokesmen for the foundation can applaud the efforts currently achieved in New York and California and at the same time vigorously oppose a proposal that would allow the states of the Midwest and the South a similar opportunity. It is difficult to understand why a charitable beneficiary in California and New York can depend upon the coordinated efforts of their Attorney General and the Internal Revenue Service while other charitable beneficiaries must primarily rely upon the disinterested efforts of a bureaucracy that is thousands of miles away and whose primary responsibility is to collect taxes as opposed to the protection of charitable beneficiaries.

#### H.R. 5729

The second provision amends Section 4944 of the Internal Revenue Code, which was intended so safeguard the funds that tax exempt private foundations hold in public trust by discouraging investments that carry a high degree of risk. To discourage jeopardizing investments the current provision imposes a tax upon a foundation when it invests any amount in such a manner as to jeopardize the carrying out of its exempt purpose.

H.R. 5729 will add to the definition of a jeopardy investment any investment by a private foundation in a single company or taxable entity in excess of 10 percent of the foundation's total assets. This mandatory diversification of foundation portfolios is intended to give substance to the prevailing prudent investor standard while avoiding the inflexibility of a legal list requirement.

Recent studies by the Subcommittee on Domestic Finance of the Banking and Currency Committee have shown numerous foundations that have an extraordinary amount of their portfolio invested in a single company or taxable entity. Obviously, such a concentrated investment entails a much greater risk of loss than a prudently invested diversified portfolio which does not place its ability to serve its charitable beneficiaries upon the performance of a single company. The fiduciary of a charitable trust has a special duty to protect its charitable beneficiaries, and this duty must not be compromised by feelings of duty or loyalty to the donor. The business judgment and direction of the

managers of the nation's largest corporations has never been a citadel of concern for charitable beneficiaries who must rely upon these decisions.

In recognizing certain problems associated with the mandatory divestiture of extremely large holdings, H.R. 5729 allows existing foundations up to five years to diversify its portfolio. This five-year provision will also apply to any new gift or bequest received by a foundation at a future time. The requirement of a diversified portfolio should not be attacked because diversification will take time and will require major alterations of investment policy based upon loyalty to a donor and the desire to protect an illusory inter vivos relinquishment of control.

In conclusion, Mr. Chairman, for many years I have been studying the need to insure that tax exempt funds held in public trust by private foundations are used solely for charitable purposes. The provisions of the Tax Reform Act of 1969 that relate to tax exempt foundations were addressed to many major areas of abuse.

The legislation I have discussed this afternoon will improve and refine the existing provisions pertaining to private foundations. I urge you not to retreat from the standards of tax exempt philanthropy you have established and not to be swayed by those who have never exercised any self-discipline and who once again have come before you requesting your support in their attempt to destroy the reforms achieved by the Tax Reform Act of 1969.

#### STATEMENT OF CHAIRMAN WRIGHT PATMAN'S COMMITTEE OFFICE

##### AN OPPOSING VIEW: FACTS OMITTED BY THE FOUNDATIONS IN THEIR ARGUMENT FOR A LOWERING OF THE MINIMUM DISTRIBUTION REQUIREMENT

The most important provision of the Tax Reform Act of 1969 was section 4942 which requires private foundations to make minimum contributions to charity each year. This provision has had the most immediate impact on private foundations and is certainly the most constructive reform achieved by the Act. To no one's surprise, section 4942 is also the provision which is under the strongest attack by the foundation community.

Essentially, section 4942 requires foundations to contribute the greater amount of either their net income less any capital gains or a fixed percentage of the market value of their assets. In order to relieve any hardship, a transitional period was provided for foundations which were in existence before May 27, 1969. The percentage of assets these foundations must contribute was set at 4.5 percent beginning in 1972. The percentage increases .5 percent each year until the maximum of 6 percent is reached in 1975.

The rationale behind the minimum payout requirement is sound. The donors to charity receive substantial current tax benefits from their contributions and, therefore, charity should also receive current benefits from private foundations. It is well documented that prior to adoption of the Act, many foundations held passive or unproductive assets over extended periods. Hence, charity was receiving very little, or no benefit from these enormous holdings while valuable tax deductions had been received by the donor.

Last week the Committee on Ways and Means heard from representatives of a group of family foundations who urged that this most worthwhile minimum payout provision be reduced. Thus, the amount that charity is to currently receive from private foundations would be reduced. These family foundations expressed a greater concern for their future interests as opposed to society's current needs. They testified that they believe the current payout requirement would make it difficult for their foundations to grow in the necessary size to serve the future interests of society, and that these future interests were more important than the present needs.

It was only after sharp questioning by Members of the Ways and Means Committee that each of the foundations who testified admitted that their individual foundations had experienced tremendous growth in asset size since the adoption of the 1969 Act and its alleged death sentence.

Any analysis of the testimony of the family foundations that fails to point out some of the fallacies or intentional omissions in their arguments justifying the reduction of the minimum payout requirement would be irresponsible and inaccurate. One example employed was an attempt to illustrate the alleged diminutive effect the minimum distribution requirement would have had on the Kellogg Foundation if the minimum payout had been in effect since 1934 at an annual

rate of 6 percent. Amazingly, that example conveniently fails to mention that, while the Tax Reform Act set the minimum payout at 6 percent, future percentages shall be determined by the Secretary of the Treasury or his delegate and shall bear a relationship to 6 percent which the Secretary determines to be comparable to the relationship which the money rates and investment yields for the current year bear to the money rates and investment yields for the year 1969. Nothing could be more misleading and inaccurate than such an example which attempts to describe the effect the current 6 percent payout requirement would have had in 1934. The average yield on corporate paper and government notes for 1934 was approximately 2 percent while in 1969 the base year for determining the payout percentage, the average yield on such investments was close to 7 percent. Therefore, a 6 percent payout requirement in relationship to the average yields for the year 1934 would be equivalent to a 21 percent payout requirement in relationship to the average yields for 1969. Surely, those who offer such an unresponsive and deceptive example cannot argue that the money rates and investment yields of 1934 are in any way comparable to those of 1969.

The Committee on Ways and Means exercised sound economic foresight when in its wisdom it authorized the Secretary of the Treasury or his delegate to prospectively adjust the rate (minimum distribution requirement) from time to time based upon money rates and investment yields as they compare to the rates and yields of 1969. For example, in 1972 the Secretary of the Treasury authorized the lowering of the transitional payout rate of 4½ percent to 4¼ percent.

Any argument favoring the lowering of the minimum distribution requirement that fails to mention the authority delegated to the Secretary of the Treasury is an affront to the wisdom of those who deliberated so arduously and intelligently in 1969.

A second example of the convenient omission technique employed by the spokesmen for the family foundations was their citation of average dividend yields on selected stocks as the proper means of measurement of investment return. Their testimony referred to a 3.8 percent dividend paid by 1,400 stocks selected by the Value Line Investment Survey. Again by convenient omission the family foundation spokesmen failed to mention that the acceptable and proper means to measure investment return is not simply the average dividend yield but the "total return concept." The total concept calls for a measurement of investment that reflects dividends and interest plus capital gain or loss, whether realized or unrealized.

An analysis of the effect of the total return measurement of investment is a more accurate and enlightening presentation of the current economic status of the foundation community.

In 1972 the total return on the stock in the Standard and Poor's 500 Stock Index was 15.5 percent. If you take into consideration the 3.8 percent rate of inflation for 1972, as reflected in the Consumer Price Index, the real "total return" for that year was 11.8 percent. The 11.8 percent real total return paints a more accurate and different picture than that presented by the family foundations. Therefore, it is difficult to believe that the present payout requirement will stymie the foundations' ability to serve charity.

When considering any request for a reduction in the minimum payout requirement for private foundations which now hold in excess of \$50 billion in assets according to the Treasury Department's most recent estimates, the Committee must be reminded that charitable beneficiaries could be deprived of over \$500 million annually for every percentage point the requirement is reduced. For this reason alone, any consideration given to lowering the minimum payout requirement should be accompanied by accurate and complete facts and a decision made only after the most careful deliberation.

THE NATIONAL ASSOCIATION OF FOUNDATIONS, INC., FOUNDATIONS  
DIVISION-EXECUTIVES DIVISION—MEMBERSHIP BULLETIN

THE WAYS AND MEANS COMMITTEE II

Chairman Wright Patman's bill H.R. 5729 is designed to amend section 4944 of the Internal Revenue Service Code. "H.R. 5729 will add to the definition of a jeopardy investment any investment by a private foundation in a single company or taxable entity in excess of ten percent of the foundation's total assets." Almost all of the members of NAF are on the donor level of private foundations and most have stock of a closely held corporation or family business. What is wrong with this! It is the American way to help others and why not have stock of a corpora-

tion founded or run by the donor in the portfolio of his own foundation. This bill would force all family foundations to divest themselves of majority stock in the donor's family business. This is ridiculous! I think it is imperative that the National Association of Foundations, Inc. make a strong case for private donor foundations. We have from now until September when the Ways and Means Committee will return to the Tax Simplification Act.

The Chairman, Hon. Wilber Mills, D. of Arkansas, is working on the plans for the International Trade Conference to be held in early September. He has had the Secretary of the Treasury, Hon. George Schultz, along with the Secretary of State, Hon. William Rogers, and the Chairman of the International Economic Council in the White House, Mr. Peter Flanigan up to testify before the Committee. They are setting up a special committee of eighteen made up of the Senate Finance Committee and the Ways and Means Committee Members to handle the work which will develop from this Conference also to delegate special powers to the President in order for him to be able to attend this extremely important Conference with the European Economic Community.

Hon. Wright Patman, D. of Texas, Chairman of the Subcommittee on Domestic Finance of the Banking and Currency Committee has been listening to Mr. George Meany, President of the AFL-CIO before his Committee all Spring.

Chairman Patman has direct jurisdiction over private donor foundations. He more than any other man in the Congress is a threat to you. He is Dean of the Texas Delegation in the House of Representatives and has a very large staff at his disposal. The Council on Foundations in New York is a public charity as was testified to by their legal counsel during the hearings in May of last year at the Ways and Means Committee when I sent you Governor George Wallace's tax statement just before he was shot.

Please let me hear from you concerning this bill. My experience is representing foundations in Washington. You know from your own experience what will affect you the most and what points you want covered. I think we should make another written statement to the Ways and Means Committee before September. The Members of Congress and this particular Committee are extremely busy and seldom have time to sit and listen at the sessions. A written statement gets all our points across without the danger of antagonistic liberal Members trying to make trouble. May I take this opportunity to tell you the members of NAF that I am always glad to hear from you either by letter or telephone or in person whenever you are in the Washington area. NAF is a trade association as such is in a better position to cope with the powerful forces which are being brought to bear on the Congress. Washington thinks only in terms of power. The foundation councils around the country do not have the political power to face such opposition. We are the only practical means for private donor foundations to defend themselves.

When the Panel on Foundations testified in April, Hon. Barber B. Conable, Jr., R. of New York, wanted to know who Mr. Peterson was. This gives you an idea of what we are up against. The only person who knew about Hon. Peter G. Peterson, Peterson Report, was Hon. Joel Broyhill, R. of Virginia, because I had given him a copy of the letter I sent to the President. I gave one also to the Chairman, Mr. Mills. Hon. Sam Gibbons, D. of Florida, told the Panel he thought the life of a private donor foundation should be limited to thirty years. After that let someone else have a chance. This is the attitude of the liberals. Hon. James A. Burke, D. of Massachusetts, said if the Panel and foundations like them did not stop complaining about the four percent excise tax they would be in serious trouble because the Committee originally wanted to tax private donor foundations at the rate of seven and a half percent. He further said if they didn't shape up the Committee would hold extra hearings and look into private donor foundations much more closely and he inferred it would be very bad for them. The Panel was quite upset when they left the hearing room because you could hear the excited rise and fall of voices in the hall just outside the door. They drew the fire of the liberal Democratic Members which was probably quite a shock to them.

All citizens have the right to petition their government of honest grievances. I shall look forward to hearing from you about the bill and I hope you will tell other foundations about this matter.

**STATEMENT OF NANCY M. GLASGOW, PRESIDENT, THE NATIONAL ASSOCIATION OF FOUNDATIONS, INC., BEFORE THE WAYS AND MEANS COMMITTEE**

Mr. Chairman and distinguished Members of the Ways and Means Committee of the House of Representatives of the 93rd Congress The National Association

of Foundations, Inc. respectfully requests that the Bill H.R. 5729 be killed in the Committee. As President of The National Association of Foundations, Inc., I do hereby formally request the Committee to reject H.R. 5729 for the good of the Private Donor Foundations of the United States and for the general good and welfare of the nation.

Hon. Wright Patman, D. of Texas, Chairman of the Banking and Currency Committee and Chairman of the Subcommittee on Domestic Finance has introduced a Bill that would destroy the family foundation in America. He would force the sale of the stock of any Private Donor Foundation having more than ten percent of its stock in any one taxable entity. This is most foundations. By this clever device, he would kill off all the Private Donor Foundations and destroy the family businesses that made it possible for these foundations to be created. Under the guise of "protecting the public interest", Chairman Patman would force the sale of the stock of every major corporation in the country. Where does Chairman Patman think he is going to find these safe investments when all of the leading corporations are on the block? He has a sword hanging over the heads of every Private Donor Foundation and large corporation in the land. Chairman Patman says sell or face a penalty! What becomes of the men who have spent a lifetime building a family business or a business run by the second or third generation? Can this be America? It sounds more like the early days of Russia when the private owners were forced out by the Bolsheviks.

I appeal to the distinguished Chairman of the Ways and Means Committee no one in the federal government knows taxes as well as you. I have told the Private Donor Foundations you were fair and being fair-minded would treat them with respect. You know much better than I how much the nation needs capital. Without risk capital there will be no country, no economy, no government and certainly no welfare. If you want this nation to survive in the present troubled times, please, Chairman Mills, hear the case for the Private Donor Foundations. All good works in the private sector of the economy need foundation support. Do you want the greatest nation on earth reduced to a moron breeding farm? Brains and wealth go together, they will not stay in a country that is unfriendly to them. Harsh laws that deprive the just from accumulating a reasonable estate will be self defeating.

It is necessary for The National Association of Foundations, Inc. to present this statement to the Committee on behalf of the members of the Association, because Chairman Wright Patman presented his Bill H.R. 5729 on the last day of the Hearings on the Tax Simplification Act. Only Members of Congress were permitted to testify before the Committee. Since no opportunity was provided for a responsible reply to the Chairman of the Banking and Currency Committee, it is necessary for the Association to present a written statement setting forth our views on this vital matter concerning the fate and future of all Private Donor Foundations. The Association has membership in 17 states and adheres to a strict Code of Ethical Conduct. Every effort is made to comply with all the laws of the land concerning Private Donor Foundations. We keep a close watch on your committee and any other committee of the Congress where the welfare of Private Donor Foundations might be affected.

"The power to tax is the power to destroy." We have now reached the stage in this country where the people are paying all the taxes they can. Certain interests are trying to put an unfair burden on someone else. Mr. George Meany, President of the AFL-CIO calls for tax reform, "tax the rich family foundations at a higher rate." Let us go free. What does organized labor give to the development of the nation? They spend what are supposed to be tax-free dollars to fund political campaigns. Our whole problem right now is a too expensive labor force. The friends of labor on the Committee will fight for their bills never realizing that they are working to destroy the system that gave them the highest standard of living in the world and has made them the envy of every other country. The enemy we face is not a foreign menace but greed from within. To the friends of American Labor on the Committee I say you need capitalists more than anyone, and you need to keep them here in this country. From now on it is American Business and Labor against the world, united we stand—divided you fall.

The future of the greatest nation in the history of the world is at stake. What you gentlemen decide will affect not only the citizens of the United States of America, but the free world as well. You have a great opportunity to make history, to bring light and reason to a very difficult and serious task. Is it too



much to ask politicians to think of the long range needs of a people? Can you think beyond the next election? Are there any statesmen in the tradition of those brave men who pledged their lives, their fortunes, and their sacred honor to found this country? On behalf of the Private Donor Foundations, I appeal to your sense of patriotism to think beyond today to the future and the goals of an entire nation. The people must be able to look to their leaders with hope and the belief that they will be heard when they petition their government.

The Bill of Rights guarantee the right of a citizen to hold private property. A man's business is his property and a man's Private Donor Foundation is an extension of that right. By what authority and divine rights, could the Committee pass a law taking away a private citizen's control over his own property? Since none of the Committee are hereditary princes, your only authority is the Constitution of the United States which states that the people shall be free from "unreasonable searches and seizures," according to the Fourth Article of the Constitution. The National Association of Foundations, Inc. respectfully requests the Bill H.R. 5729 be killed in the Committee on the grounds that it is unconstitutional and violates the Fourth Article of the Constitution of the United States of America.

**THE NATIONAL ASSOCIATION OF FOUNDATIONS, INC., FOUNDATIONS DIVISION—  
EXECUTIVES DIVISION—CODE OF ETHICS**

**PREAMBLE**

The National Association of Foundations, Inc. in order to inspire public confidence, affirm the fairness of the self-assessment tax process and to indorse the basic principle of promoting private philanthropy through tax-exemption, does proclaim ethical standards of conduct for foundations as follows:

- (1) Be ever mindful that they are organized for philanthropy and not for private gain.
- (2) Recognize that they hold a public trust.
- (3) Realize that tax-exemption imposes special obligations to operate solely in the public interest.
- (4) Never permit a foundation to be used for the self-service or private interests of its donors, trustees, directors, officers or employees.
- (5) The foundations recognize the need to make distributions annually commensurate with their incomes and consistent with their respective charters.
- (6) To make investments as a prudent man would in a fiduciary capacity.
- (7) Willingly furnish required information when requested by duly constituted local, State and Federal authorities.

**PREPARED STATEMENT BY JOS. C. CORNWALL, PRESIDENT OF  
THE FUND FOR NEW JERSEY**

Senator Vance Hartke has requested statements on the impact of current economic conditions on foundations and on the recipients of foundation grants. The Senator is to be commended for examining this question and providing a public forum for better understanding of the implications of current economic conditions for foundations.

The Fund for New Jersey gives highest priority in its grant-making to those projects which will have the effect of increasing public awareness of major problems in New Jersey and which stimulate action on those problems. The largest proportion of our annual grants go to groups engaging in public-policy analysis and research, information dissemination, and to those encouraging citizen action on a variety of problems. Our total grants in recent years are depicted in the following table:

1970 -----	\$533, 125
1971 -----	616, 021
1972 -----	642, 218
1973 (including two one-time capital gifts totalling \$744,625) -----	1, 434, 751
1974 estimated -----	656, 708
1975 projected -----	1 475, 000

<sup>1</sup> As of September 30, 1974, the Fund's Corpus was reduced by one-sixth pursuant to a Plan of Reorganization.

A quick check of the above table demonstrates that the current economic conditions have had a profound, direct, and negative effect on the money available to recipients of the Fund. As with other funds—whether profit or non-profit—this Foundation operates on a total-return concept. Specifically, it is our objective to realize from dividend and interest income, and in the appreciated value of stocks and bonds, an annual return averaging 9 percent. Through 1973 it was our policy to liquidate appreciated securities and to use the proceeds for additional grant-making. In a market where there are only depreciated stocks, to pursue such a policy would permanently impair the financial potential of the Foundation. Therefore, in 1974 the Trustees decided to distribute only the amount realized from interest and dividend payments.

Thus, at a time when the needs of recipient organizations are growing because of the devastating effects of inflation, the Fund has less money available. In all probability, the financial problems of the Fund will mean that organizations presently receiving grants, and which in normal times could expect grant renewals, will not receive them. Further, it means that whereas in past years one out of every twelve or thirteen organizations applying to the Fund could expect to receive assistance, that negative ratio will necessarily grow, perhaps to as high as one out of every twenty. Moreover, the ability of the Fund to assist organizations facing short-term emergency conditions is greatly reduced, as is the capacity of the Fund to stimulate new efforts in areas which are being ignored by existing organizations. Thus, much of the creative work which has been accomplished by the Fund and recipients in recent years will be stifled.

As a result of these conditions, the Fund is operating under the most stringent financial guidelines. During 1974 we have asked recipient organizations to defer payments until 1975 so that we could avoid having to liquidate securities to meet our commitments. While this relieves the situation temporarily, the result is to have less money available than anticipated in 1975 for new programs.

VANGUARD FOUNDATION,  
San Francisco, Calif., November 22, 1974.

HON. VANCE HARTKE,  
*Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.*

DEAR SENATOR HARTKE: Vanguard Foundation supports small, charitable groups in and around the San Francisco Bay Area. Our grantees are organizations which "can't get money anywhere else", that is, organizations which are not funded by most other foundations because they appear too unusual or too risky. In doing so, we have found that there are many classes of people and social causes which are in dire need of assistance but are almost entirely cut off from the philanthropic mainstream. Although many of these groups are firmly grounded in large numbers of beneficiaries and are committedly forward looking, they rarely pass the screening stages of most foundations.

To my mind, this exclusion is ultimately based on the composition of the Boards of Directors of these foundations. Board members are usually chosen on the basis of accomplishment in fields unrelated to philanthropy, and quite naturally, their interests and experience tend not to be similar to those of the people they are trying to help. So, while they can bring objective perspective and management skills and experience to the decision making process, they are often quite ignorant of the context within which grants are being made—the daily lives of the people associated with grantees. I would like to see more individuals from the recipient's class of people involved in positions of influence in foundation boards and administrations.

To my mind, different sorts of rules apply to philanthropy than to profit, scholastic, or service oriented professions. David Rockefeller, Jr., President of the Rockefeller Family Fund, uses the phrase "venture philanthropy", analogous to venture capital, to convey the idea that foundation funds can and should be used for experimentation in the social arena. Philanthropic assets are unique in that, while they comprise a very small percentage of the total dollars expended for social programs, they are in a position to respond more quickly and with much less bureaucracy than other kinds of funding. But a great many board members avoid taking any chances with the money under their control. I think that foundations could and should be far more responsive to social currents than they are now, particularly at the grass roots level.

For background, Vanguard is comprised of 15 young people who have inherited money and give a portion of their incomes to our fund. We have been operating for three years now and have helped a similar group get started in Boston. Examples of our funding are Change for Children, which researches children's literature for racist and sexist content and holds workshops for teachers of the San Francisco School District, and the National Jailhouse Lawyers Association, which provides legal briefs and technical assistance to inmate lawyers.

I hope these observations are of some assistance to you. Please let me know if I can be of any further assistance.

Sincerely yours,

OBIE BENZ, *President.*

COLUMBIA UNIVERSITY IN THE CITY OF NEW YORK,  
New York, N.Y., November 27, 1974.

SUBCOMMITTEE ON FOUNDATIONS,  
COMMITTEE ON FINANCE, U.S. SENATE,  
Washington, D.C.

GENTLEMEN: These brief comments reflect my personal views and are not to be assumed as necessarily representing the opinions of any organization with which I am associated. I am Professor of Economics, Columbia University, and Economic Consultant, Tax Foundation, Inc. (The latter is not the type of foundation under consideration here.) For six years I was on the Board of the Lincoln Foundation. My service expired four years ago.

1. Your committee could make a positive contribution by trying to counteract the atmosphere of suspicion, antagonism, and criticism which seemed to gain force in the 1960's. The many kinds of constructive work of foundations far outweigh, in my view, any disadvantages. Whatever the seriousness of abuses, positive achievements have been, and are, substantial. Perhaps focus on the bad elements was needed to build support for legislation. Any human institution will have faults. But the world of foundations, it seems to me, ought to receive encouraging backing from leaders in Congress and other walks of life. The admonition to "accentuate the positive" applies.

2. The 4 percent tax seems clearly too high. The notion of earmarking revenues or of charging for government services may or may not be wise on balance. In this particular case the burden may be the most regressive in the entire American system. Whether or not such is the case, the tax deprives the beneficiaries of foundations of needed funds.

3. The pay-out provisions ought to be reexamined in the light of uncertainty, inflation, changes in asset values, and the problems of maintaining real purchasing power through time. The concept of compulsory pay-out calls for study in relation to other goals. My personal preference would be rates which do not impair the prospects of survival without contraction. I would favor greater liberality and flexibility in the form of longer time periods—five years or a decade—with opportunity to use hindsight to take account of actual changes in the worth of assets, general inflation, and real yields.

4. Forms, regulations, reports, controls, all these involve costs. The costs are of many types, not the least being the time, energy, and thought of leaders of foundations and their staffs. The U.S. Government would serve the people wisely, I submit, by reducing the burden of reporting and complying with regulations. How much deadweight loss is now imposed? Deliberate effort to simplify forms, reduce frequency, relax controls, and generally moderate regulations would help foundations serve the people.

Respectfully yours,

C. LOWELL HARRISS, *Professor of Economics.*

PREPARED STATEMENT SUBMITTED BY JOHN W. ANDERSON FOUNDATION,  
VALPARAISO, IND.

The Trustees of John W. Anderson Foundation appreciate the opportunity to submit this Statement to the Foundation Subcommittee of the Senate Finance Committee. The Trustees believe that the current state of the economy poses

serious problems for foundations and their charitable beneficiaries. Specifically, John W. Anderson Foundation is concerned that the state of the economy and the operation of the Internal Revenue Code minimum distribution provisions may soon force the Foundation to divest itself of its assets at artificially low prices, to the great detriment of its charitable beneficiaries, including Boys Clubs, colleges and universities, hospitals and college students in Indiana and elsewhere.

Since the death of John W. Anderson in 1967, John W. Anderson Foundation has owned more than 90% of the stock of The Anderson Company ("ANCO"), a manufacturer of windshield wiper arms and blades in Gary, Indiana, employing some 1,400 people. Under Section 4943 of the Internal Revenue Code, added by the Tax Reform Act of 1969, John W. Anderson Foundation is required to divest itself of a portion of its ANCO stock ("excess business holdings"). Fortunately, Congress anticipated that foundations would have difficulty disposing of closely held stock over a short period of time and, accordingly, in Section 4943 gave foundations holding such stock on May 26, 1969, grace periods of 10, 15 or 20 years to eliminate excess business holdings. Since John W. Anderson Foundation owned over 90% of the voting stock of ANCO on such date, it was given 15 years to eliminate its excess business holdings.

However, the current state of the economy has created conditions which threaten to force the Anderson Foundation to divest some of its ANCO stock which Congress determined it should be allowed to keep until 1984. The problem is brought about by the operation of Section 4942, which requires a private foundation to distribute to charity each year *the greater of* its "minimum investment return" or its adjusted net income. The "applicable percentage" for computing the minimum investment return was raised by the Commissioner of Internal Revenue from 4.375% in 1973 to 5.5% in 1974, and presumably the minimum investment return will be set at a comparably high rate next year since Section 4942 requires it to be set in relationship to money rates and investment yields prevailing in 1974.

Since the Foundation's property consists almost entirely of its holdings in ANCO, it is almost entirely dependent on dividends from ANCO to meet the distribution requirements under Section 4942. At the same time as the minimum investment return applicable percentage is being raised due to high interest rates prevailing in the economy, the state of the economy has caused substantial problems for ANCO, including constant cost increases accompanied by strong resistance to ANCO price adjustments, the current slackening of demand in the auto industry and tight money, which make it difficult for ANCO to maintain its current dividend payment to the Foundation, much less increase it. Consequently, if the Foundation cannot meet its distribution requirements under Section 4942 out of dividends from ANCO, it has no choice but to attempt to sell ANCO shares in the currently depressed stock market. Of course, the sale of a substantial amount of such shares (an initial public offering would require a substantial sale) in a depressed market would greatly diminish the value of its assets held for charity and would not be in the best interests of the Foundation's charitable beneficiaries throughout the state of Indiana and elsewhere. Such a result would be directly contrary to the intent of the Tax Reform Act of 1969, which sought to maximize funds available for charitable purposes.

The Senate recently took steps to deal with just such a problem, as it relates to the Herndon Foundation, when the Senate added Section 4 to H.R. 6042, which provides in effect that the Herndon Foundation is required to distribute only the dividends actually paid on the Atlanta Life Insurance Company stock it is permitted to keep, and the minimum investment return does not apply to such stock. On page 6 of the Senate Committee on Finance Report No. 98-986 to accompany H.R. 6042 it is stated that it had come to the Committee's attention that the charitable distribution provisions were forcing divestiture of stock which Congress determined the Herndon Foundation should be permitted to keep, and, as a result, the intent of Congress in 1969 was "being frustrated because of the operation of the minimum investment return provision."

Likewise, because of current economic conditions, the Section 4942 distribution provisions could soon force the divestiture of stock which Congress determined John W. Anderson Foundation should be permitted to keep until 1984. Consequently, the specific and well considered intent of Congress expressed in Section 4943 which gave foundations certain specific periods before requiring divestiture of closely held corporation stock is being frustrated because of the unanticipated operation of the minimum investment return provisions of Section 4942. Although it is acknowledged that the Herndon Foundation was given special treatment

by the Tax Reform Act because of its stock holdings, likewise Section 4943 gave Anderson Foundation and other foundations a similar type of treatment because of their May 26, 1969 stock holdings. Accordingly, the Trustees of the Anderson Foundation believe that it and other foundations similarly situated are entitled to the same relief from the operation of Section 4942 as given the Herndon Foundation.

Unfortunately, the Tax Reform Act governing private foundations was developed in 1968 and 1969 against a background of economic conditions which is far different than that prevailing today. For example, the public offering of a new issue, such as ANCO, which would have been met by investors with enthusiasm in 1968 is almost impossible to sell in 1974. We appreciate your holding hearings on the very serious problems that these changed economic conditions have created and we hope that legislation will be passed to ameliorate these problems.

Thank you for your consideration of this matter.

EDWARD C. LARSON,  
*Chairman.*  
RICHARD S. MELVIN,  
*Vice-Chairman.*

WINSTON-SALEM, N.C., December 10, 1974.

Hon. VANCE E. HARTKE,  
*U.S. Senate,*  
*Washington, D.C.*

DEAR SENATOR HARTKE: I am encouraged by your letter of November 12 to make a suggestion to you as Chairman of the Senate Subcommittee on Foundations and other charitable organizations.

Everyone across the Nation is concerned with the increasing growth of bureaucracy in Washington. It would be terribly helpful if your Subcommittee could pay for an investigation of the costs of support from federal, state, county and city versus individual corporate and foundation support.

Years ago I remember reading a report that it costs nothing for an individual to give to a federally approved charitable organization. The cost to business was so minimal as to be unobservable. The cost to foundations was somewhere in the neighborhood of 3 to 4%. BUT it cost a city a dollar to give away a dollar and a county two dollars to give away a dollar and a state five dollars to give away a dollar and the federal government between ten and twelve dollars to give away one dollar. In other words, the federal government had to collect between eleven and thirteen dollars in order to make one dollar available due to the immense amount of paperwork, etc. involved.

I have served on the Board of the National Endowment for the Arts for an extended period. I am still working with its Chairman, Nancy Hanks. However, the National Endowment is rapidly simulating its brother organizations and is becoming an incredible bureaucracy.

After a highly qualified Panel on a given art has approved a grant and after the whole Endowment Board has approved a grant, there are 129 steps to be followed before the grant can actually be presented to the recipient. This is such a complex procedure that in some cases recipients have not received the grant for over a year and have had to borrow the money at high interest rates to handle the situation.

If, on the other hand, industry had been encouraged to give 3% instead of its less than 1½%, much of the need for support of the National Endowment for the Arts would not be necessary.

I have recently had opportunities to hear of far worse happenings in HEW. This is an old organization and far more bureaucratic.

It occurs to me that rather than discourage foundations and donations from individuals and corporations, they should be encouraged.

Might I suggest that the Government carefully review the major eleemosynary organizations in this country—such things as hospitals and private colleges and other educational institutions, for example. Perhaps the Government would realize that if donations could not support their needs, the Federal Government would have to do so.

There might be created a new category of eleemosynary organizations which would allow individuals, for example, to give a full 50% of income in appreciated assets, if the last 20% were given to these specially designated institutions.

We must do something to cut down on bureaucracy and this looks like a good way.

Many thanks for your ear.

Yours truly,

R. PHILIP HANES, JR.

TESTIMONY OF VERNON E. JORDAN, JR., EXECUTIVE DIRECTOR, NATIONAL URBAN LEAGUE, INC., ON FOUNDATIONS AND THE ECONOMY

Mr. Chairman and members of the subcommittee, I am Vernon E. Jordan, Jr., Executive Director of the National Urban League, Inc. I am pleased to be here today in response to Senator Hartke's invitation to share with you the views of the League as a recipient of many foundation grants over the years on the impact of the prevailing and forecasted economic conditions in this country.

The National Urban League is a non-profit, non-partisan charitable and educational organization which was founded in 1910 to secure equal opportunities for black Americans and other disadvantaged minorities. It is governed by an interracial board of trustees, and it seeks to improve race relations among all people of the United States.

Among the League's pursuits are programs to enhance equality of employment and housing opportunities, to provide alternatives to traditional educational methods which have failed minority youth, to develop and strengthen family life, to encourage active and responsible citizenship by minorities, and to assist individuals in solving their problems in the areas of employment, education, health, and economic development. The League also acts as an advocate to present the minority point of view on matters of concern to its constituency.

Operating through its 103 local affiliates in 36 states and the District of Columbia, the League maintains a national headquarters in New York City with regional offices in Akron, Atlanta, Saint Louis, and Los Angeles. A Washington Bureau and a Research Department are located here in the nation's capital. The National Urban League and its affiliates have a combined staff of more than 2,500 assisted by approximately 20,000 volunteers who bring expertise and experience to the resolution of the problems facing minorities.

My comments today will be in the context of the fund raising effort required to support the activities of the National Urban League itself rather than to include the variety of situations facing each of our local affiliates. To a greater or lesser degree, I am sure that my comments apply to our local affiliates as well if for no other reason than some of the funds raised by the National Urban League directly benefit the affiliates.

During the last three fiscal years, the funds raised by the League from private sources have included a high percentage from various foundations. The percentage from foundations has ranged from approximately 80% to approximately 43% of the private funds raised. Some of the foundation funds have been earmarked for specific uses, but the trend over the last several years has been an increase in the percentage of foundation funds which can be used for the support of the League's general operations. During the last three fiscal years, the League has received over six million dollars in grants from various foundations. Suffice it to say, the League is heavily dependent upon foundation grants for the continuation of its operations.

The League, unlike most of its sources of private funds such as corporations and foundations, has no reserve of assets upon which it can draw in times of adversity. It is wholly dependent upon current income to continue its operations. An interruption of that income not only causes an immediate cessation of some portion of the League's operations, but it has an impact that can linger for years in the future because valued staff members and program momentum are lost.

Most of the foundations from which the League derives support in the form of grants rely on their income from investments rather than an invasion of the foundation corpus to meet its commitments. In a sense, this is double jeopardy of a sort for the League because other types of fund sources such as corporations rely on the same capital investment base as do the foundations. A slackening of income to the foundations translates rapidly into a decline in the level of grants to the League while alternative sources of funds dry up simultaneously. Of course, many foundations could invade corpus to continue making grants, but that isn't a practical alternative in today's investment market because the corpus has already been drastically reduced by deflating investment market

values. Even if lowered investment values were not as great a consideration as they must be today, the habitual invasion of corpus would result in a borrowing from future needs which do not appear to be declining.

Except for such foundations such as Ford which have regularly invaded corpus in the recent past, most foundations have been able to maintain the current dollar level of their income and grants. That has meant that the League has been fortunate enough to maintain its income. The impact of inflation, however, makes maintenance of income an illusory comfort. The costs of operation have risen sharply over the past several years, and I suppose that they will continue to do so for the next several years. The League has managed to hold the line on its general budget, but that has meant that the real purchasing power of that budget has declined at an ever increasing rate. During the last fiscal year and during this fiscal year we have had to allow some rises in budgetary level just to maintain our effectiveness. The most unfortunate aspect of this is that times of economic adversity such as we are experiencing now creates a higher demand for the kinds of services that the League provides.

I hope that my outline of the League's situation has been sufficient to suggest that the government should adopt a flexible policy with regard to the financial aspects of private initiative to solve the pressing problems of our society. You must not wait until the crunch of declining foundation and corporate income is upon us. It will be too late to prevent curtailment and disruption of the services rendered by private organizations such as the League.

One of the most obvious measures to mitigate the impact of continuing inflation and possible diminution of income that this subcommittee could recommend to Congress is the reduction of the current 4% excise tax imposed upon the foundations. It is my understanding that a reduction in that tax rate to 2% would result in an increase of about \$35 million available for grants. Such a reduction, I am informed, would still generate more than enough revenue to fund the legitimate audit operations of the Internal Revenue Service. This single reform would go a long way to mitigate the impact of inflation on the flow of grants from foundations. There is an immediate and pressing need for such relief because other sources of income to the League are not likely to increase their donations by an amount sufficient to offset the increase in inflationary costs.

Racial minorities bear a disproportionate amount of the burden of our times. I am sure that the unemployment rate for blacks and other minorities will be no less than 11.5% when this month's statistics are released. We must all constantly strive to remove this sort of inequity from our society. We need relief now, before the dominoes fall to stifle our resources when we need them most.

Thank you, Mr. Chairman, for having solicited the views of the National Urban League. I will be happy to answer any questions that you or your colleagues may have.

---

**TESTIMONY OF PETER HUNT, EXECUTIVE DIRECTOR, URBAN DYNAMICS/INNER CITY FUND**

Mr. Chairman, I represent a rather unusual organization of associated foundations in Chicago, Urban Dynamics/Inner City Fund. We are not endowed and our funds derive from annual contributions from family foundations, corporations and individuals. There were thirty-nine members and contributors in 1973 in amounts ranging from \$100 to \$15,000. There have been thirty-four thus far this year. As an organization with publicly supported status, we have a board of twenty-five where a minority of donor representatives lean heavily on the experience and judgment of fourteen professional directors in making decisions on grants. There are nine Blacks and three Latinos on the board.

We are also unusual in that our area of interest is a specialized one. Our priority focus in grantmaking is on local projects which have been initiated and are controlled by inner city residents. Through grants from us, parallel grants from our member foundations and technical assistance provided by our staff we hope to help new organizations develop into stable institutions that can meet needs and speak to social issues affecting inner city residents. We feel that this is a risk area where the lead in funding ought properly be assumed by private philanthropy rather than government.

Unfortunately the funds which have been available for our efforts have been far too low and current economic conditions, coupled with uncertainty as to the future of private philanthropy in general, have hindered us still further. We voted slightly over \$100,000 in grants last year and can only estimate about \$80,000 in

grants this year. Even when we include the further grants to organizations supported by us which were made by our contributors—about \$120,000 last year—the total is still quite small in relation to need.

Not only has our dollar total diminished, but another of our assumptions, that a grant from us could help introduce an inner city newcomer into the philanthropic marketplace, has been challenged by the reality of diminished funds and increased competition from inflation ridden traditional grant recipients. We have felt the need to concentrate more dollars on fewer recipients in order to give them a better chance of survival.

Testimony before the Subcommittee on Foundations, Finance Committee, United States Senate by Peter Hunt the Fund's Executive Director.

I wish I could suggest to you some appropriate way in which government could encourage the flow of philanthropic money into innovative efforts like our own which are properly the responsibility of private sources in a pluralistic system. I am afraid that further regulation, at a time when some public figures have suggested the modification or abolition of tax credits for charitable undertakings, would only increase the worry and uncertainty on the part of givers which is part of our problem. In addition, it is government's own lack of forthright measures to manage the economy and its reluctance to fund social, educational, and cultural programs that receive state funds in other countries that has helped produce the current gap between social needs and available money. More is being demanded of private philanthropy than it can be expected to deliver. I speak for at least one segment of need in one city where expectations of inner city residents have been far exceeding the ability of private sources to respond.

The missed opportunities and the frustrated hopes with which we are in daily contact are the painful background to the work we are trying to do.

---

**RESOLUTION ADOPTED BY THE AMERICAN ASSOCIATION OF PRESIDENTS OF  
INDEPENDENT COLLEGES AND UNIVERSITIES**

Our association of private college and university presidents has as its overriding purpose to protect the independence of the independent college. The independence, indeed the existence of these institutions, is threatened by the pincers of the public-private tuition differential and the inexorable inflation.

Given the financial circumstances of today, the private college's best hope for continued service is to increase its margin of gift revenues. It is, therefore, our urgent plea that the Congress take no further action to reduce the tax incentives for philanthropy to higher education.

Among the proposals for changes in the tax structure there are three which we believe would have the most devastating impact upon our gift revenues:

1. Any change which would decrease the exemptions now granted on gifts of property with an appreciated value.

2. Any change that would diminish the percentages of adjusted gross income or estate which are now eligible for deductions.

3. Any establishment of a minimum taxable income which would include charitable contributions within the definition of that minimum taxable income.

We wish to register our conviction that:

1. Gifts to higher education are not "loopholes."

2. It is good policy for the government to encourage gifts to public and private colleges.

3. The need for gift support to higher education is not less but greater than when the tax laws were last revised.

Therefore, we hope that all members of Congress, rather than taking action to diminish the tax incentives for gifts to educational institutions, will consider increasing those incentives.

---

**MERRIMACK VALLEY TEXTILE MUSEUM,  
North Andover, Mass., December 13, 1974.**

**Senator EDWARD W. BROOKE,  
U.S. Senate Office Building,  
Washington, D.O.**

**DEAR SENATOR BROOKE:** Subsequent to the Tax Reform Act of 1969, the Merrimack Valley Textile Museum and eighty other museums have been classified as



private foundations subject to an annual four percent tax on endowment income.

We feel such treatment for accredited museums was unintentional and that it is discriminatory. The effect of this poorly written legislation is to reduce the ability of the affected museums to deliver public services. For example, had the Textile Museum not been forced to pay income taxes of \$6,000 this year, we could have used this much money to expand and improve our education program for school-aged children.

It makes little sense, it seems to me, to use tax laws to discourage public service institutions from serving the public. I hope you agree and that you will make every effort to correct this inequity.

Sincerely yours,

THOMAS W. LEAVITT,  
*Director.*

ALVIN M. BENTLEY FOUNDATION,  
*Owosso, Mich., November 7, 1974.*

HON. VANCE HARTKE,  
*U.S. Senator, c/o Mr. Michael Stern, Staff Director, Committee on Finance,  
Room 2227, Dirksen Senate Office Building, Washington, D.C.*

DEAR SENATOR HARTKE: The Alvin M. Bentley Foundation was founded in 1961 by Mrs. Bentley and the late Congressman Alvin M. Bentley.

Its principal benefaction is in the field of scholarships given to high school graduates of the State of Michigan for use in all institutions of higher learning in the State of Michigan.

Currently, the program provides for 49 scholarships to senior colleges and universities and 30 scholarships to junior and community colleges. Students are awarded scholarships by the institutions of learning from money furnished by the foundation. In the case of the senior colleges, the benefit is \$750 per student, and the other, \$500.

Since the establishment of the foundation, approximately 1,000 students have benefited from the program.

In addition to the foregoing, we provide funds for education of governmental processes by high school students and numerous other additional benefactions.

I address you on behalf of the small foundations and wish to indicate the impact of the federal tax as it applies to small foundations.

This foundation in 1973 had an income of \$122,399.76. The total expense of administering the affairs of the foundation was \$12,792.29, or 10.56% of income. The federal tax was \$4,187.17 and represented approximately one-third of the expense.

The tax of over \$4,000 deducted from available scholarship funds means that approximately nine students were deprived of funds for educational purposes.

The affairs of the foundation (and through my investigation of most small foundations) are administered by civic-minded, responsible persons, who in most instances receive no compensation and little expense money. The trustees of these foundations not only scrutinize the benefits, but are informed concerning public needs and the availability of funds from various sources to carry on the work and programs of beneficiaries. Very little of the funds are wasted on duplicative, non-innovative or self-serving efforts. Grade information on all scholars receiving benefits is required, enabling the administrators of the grants to monitor the use of the funds by the schools and the students.

As an example of the operation of this small foundation, I am annexing a copy of the financial operation for the fiscal year 1973-74.

It is reported that of the moneys received from the tax by the federal government, much less than fifty per cent is required for supervisory purposes. The tax should therefore be reduced to make available all possible funds for the purposes of the foundation.

--- Cordially yours,

NORMAN L. DES JARDINS,  
*Vice President,*  
*—Alvin M. Bentley Foundation.*

## Recapitulation—Alvin M. Bentley Foundation—Fiscal year 1973-74

Cash balance July 31, 1973.....	\$142.54
<b>Receipts:</b>	
Dividends and interest.....	122,399.76
Refund—Delta College.....	31.50
Conference of Michigan Foundations, refund.....	45.00
Clark Bentley gift.....	5,000.00
Capital sales or redemptions.....	324,000.00
Subtotal .....	451,476.26
Total .....	451,618.80
<b>Disbursements:</b>	
Rental .....	1,860.00
Michigan Press Reading Service.....	304.00
Detroit Bank & Trust Co. fee.....	2,462.17
Grants—Other (see exhibit).....	40,822.50
Capital purchases.....	292,000.00
Scholarships .....	105,000.00
Miscellaneous (see exhibit).....	8,166.12
Subtotal .....	450,614.79
Cash balance July 31, 1974.....	1,004.01
Total .....	451,618.80
<b>1973-74 Grants—Alvin M. Bentley Foundation:</b>	
United Negro College Fund.....	3,000.00
Salvation Army.....	100.00
Seventh-Day Adventist Church.....	25.00
University of Michigan Endowment Fund—Boak Fellowship.....	2,497.50
Alumni Association of the University of Michigan.....	750.00
Central Michigan University—Anspach pledge.....	6,000.00
Olivet College—Operation Bentley.....	5,000.00
Shiawassee United Fund.....	3,200.00
Central Michigan University—Youth Arts Festival.....	1,000.00
Olivet College—Operation Bentley.....	15,000.00
Alumni Association of the University of Michigan.....	750.00
Wilberforce University.....	1,000.00
Hawaii Preparatory Academy Scholarship Fund.....	2,500.00
Total .....	40,822.50
<b>Miscellaneous expenses—1973-74:</b>	
Crest, Inc.....	50.40
Brookes Printing—Scholarship certificates.....	116.48
Publication—Annual report.....	14.50
Lettering scholarship certificates.....	40.70
Detroit Bank & Trust Co. (separate item).....	140.00
Flint Tent & Awning.....	120.44
Johnson's Foodland.....	50.00
Norman L. Des Jardins, scholarship luncheon expenses.....	398.17
Des Jardins & Des Jardins, office expense reimbursement.....	14.00
Travel—Dr. Charles L. Auspach.....	146.64
Ellis Photography.....	4,187.17
Private foundation excise tax.....	225.00
Preparation tax return.....	150.00
William H. Heid, appraisal.....	27.63
Interest on deficiency—Private foundation tax.....	25.21
Marriott Inn, room.....	2.25
Telephone call Cadwallader, Owosso.....	39.32
Crest, Inc.....	1,185.00
Dorothy Cross, stenographic.....	684.28
Des Jardins & Des Jardins, reimbursement office expenses.....	539.93
Arvela D. Bentley, office expense reimbursement.....	8,166.12
Total .....	8,166.12

SUBURBAN ACTION,  
*Yonkers, N.Y., December 19, 1974.*

HON. VANCE HARTKE,  
*U.S. Senator, Senate Office Building,  
Washington, D.C.*

DEAR SENATOR HARTKE: Howard Marlowe of your staff on December 6th sent to me a copy of the testimony at the hearings you conducted on the subject of Private Foundations in May and June of this year.

The hearings contain false information about my organization, the Suburban Action Institute. I do not intend to dignify or lend credence to the irresponsible and hysterical attack made on the Institute in testimony before your Committee. The sad truth is that many Americans are not yet willing to allow racial and economic minorities the same rights and opportunities under the law as are available to themselves. As a result, they will violently resist the efforts of any organization, such as ours, that is committed to fostering racial and economic integration of their schools and the communities in which they reside. I think this overriding racial motivation is self-evident from the record before the Committee.

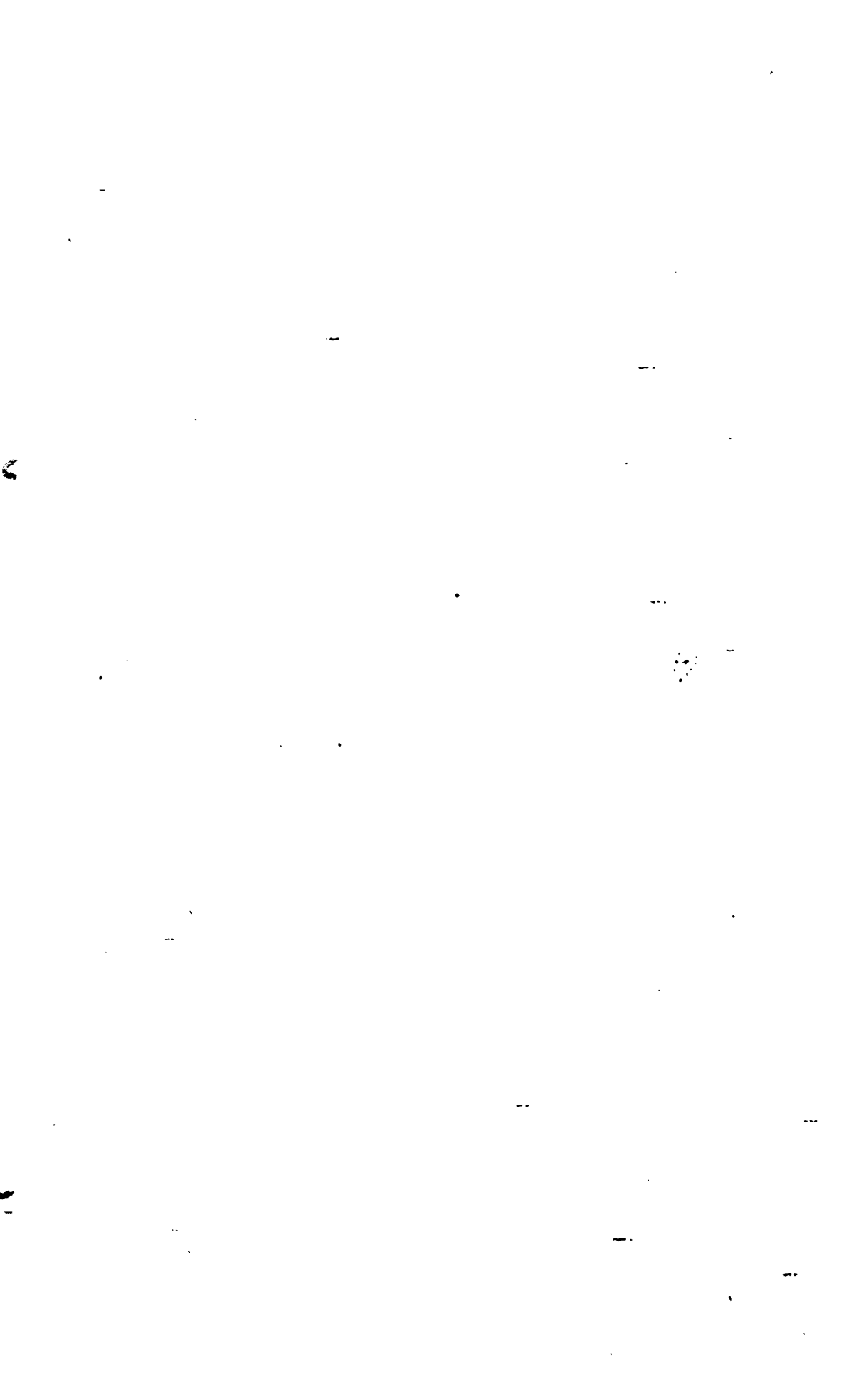
I wish only to supplement the record by noting that the Internal Revenue Service has just completed a year-long audit and examination of Suburban Action in response to the same charges that were made in your hearings. We have just recently been advised by the IRS that it has concluded, on the basis of this thorough examination, that Suburban Action is properly classified as a non-profit, tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code.

At the time the Internal Revenue Service began its examination we publicly stated that we welcomed the review so that we might be fully exonerated. We were confident that our activities placed us well within the law.

I hope at last that we can return our undivided attention to the urgent task of "opening the suburbs" so that suburban communities will share the responsibility with our beleaguered cities for providing decent housing and environment to all citizens.

Sincerely,

PAUL DAVIDOFF,  
*Executive Director.*



---

**Appendix B**

**Communications Submitted to the Subcommittee on Foundations in Response to a Subcommittee Request for Views on the Impact of the Tax Reform Act of 1969 on Foundations and the Recipients of Foundation Grants.**

---



ELSA U. PARDEE FOUNDATION,  
Midland, Mich., November 12, 1974.

HON. VANCE HARTKE,  
Chairman of the Subcommittee on Foundations, Michael Stern, Staff Director,  
Committee on Finance, Dirksen Senate Office Bldg., Washington, D.C.

DEAR SENATOR HARTKE: As a staff member and assistant to the Secretary & Vice President of the Elsa U. Pardee Foundation I wish to commend your endeavors in fairly reviewing all aspects of foundation funding and for your understanding of the problems facing foundations today.

Your report of September 26 in the Congressional Record and your list of topics for projected study for the Subcommittee on Foundations I thought commendable. It was interesting to note however the length of Series #1 when Series #2 represents the substance of the need for foundations and their support.

As a retired registered nurse and an "over 60" widow I would hope that the problem solving with foundation assistance would be your priority study. Should this assistance be siphoned off in an "anti-capital", "tax the rich" attitude, it would raise havoc with a great many excellent programs for people that are as diverse as America itself.

No doubt there are many who are unaware of the scope of foundation funding in research, art and charitable fields. I only wish they might see the flood of Annual Reports that come from all over this land. Certainly they may not all be effective but not all government or private ventures are productive either. In the private foundation funding it appears to me to reflect the use of more individual decision. Basically this is what most people prefer I believe.

I appreciate being a small part of the foundation scene and the country that permits and encourages me to address our elected representatives as well.

Sincerely yours,

ANNA MAY JOHNS.  
(Mrs. Allen Johns)

---

THE ROBERT A. WELCH FOUNDATION,  
Houston, Tex.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: In response to your letter of October 11, 1974 we are very much interested in the statement of the views of the Subcommittee on Foundations with respect to the reduction of the excise tax from 4% to 2%. We respectfully suggest that the conclusions and recommendations of the Subcommittee, as well as those of the Treasury Department, are substantially correct.

For example, in the years 1970-1973 inclusive, the Welch Foundation paid an excise tax of \$810,369.00. All of this money paid as an excise tax was directly taken from the promotion of basic chemical research in colleges and universities. That basic chemical research, we submit, offers the key to the solutions of many of the problems of our modern society, such as the energy crisis, a cure for cancer, and the removal of pollution from our environment.

At the convenience of the Committee, we would be happy to submit a report by our Director of Research to demonstrate how such research, promoted and supervised by The Robert A. Welch Foundation, holds a promise of these solutions. The excise tax simply removes a part of the funds so necessary for these underlying experiments and conclusions so vital for our Nation's welfare.

Sincerely yours,

JACK S. JOSEY,  
President, The Robert A. Welch Foundation.

ELSA U. PARDEE FOUNDATION,  
Midland, Mich., November 12, 1974.

HON. VANCE HARTKE,  
Chairman of the Subcommittee on Foundations, Michael Stern, Staff Director,  
Committee on Finance, Dirksen Senate Office Bldg., Washington, D.C.

DEAR SENATOR HARTKE: The trustees of the Elsa U. Pardee Foundation greatly appreciate your continued concern and interest in the plight of private foundations in the current economic crisis. We would like to state and emphasize again some of the points called to your attention in our letter to you July 23, 1974.

Because the 4% excise tax has proven to be excessive, we recommend it be adjusted to 2% to reflect the actual requirements for auditing foundations. Perhaps the rate should fluctuate with the financial requirements for the purpose of Section 4940 but we recommend the 2% figure.

The minimum distribution of net investment income requirements for private foundations should be changed to reflect the actual yearly income of nearly all foundations.

The present rate requires foundations to sell out their assets every year in order to meet the pay out requirement. The other choice is to invest the assets in higher paying bonds or Treasury bills which at the present rate of inflation lowers the true value of the assets year after year. Either choice spells the elimination of foundations over a period of time or at least impairs their charitable activities.

We do not believe it was the intent of Congress to eliminate foundations by the Tax Reform Act of 1969 which with other legislation pertaining to foundations are well constructed and help correct many actual and potential abuses of the administration of funds for charitable purposes.

However, after four years of experience it is now necessary to change the requirements that are excessive and harmful to long term health of private charity.

Sincerely,

WILLIAM W. ALLEN,  
Vice President and Secretary.

---

ELSA U. PARDEE FOUNDATION,  
Midland, Mich., July 23, 1974.

HON. VANCE HARTKE,  
Chairman, The Senate Finance Subcommittee on Foundations, Michael Stern,  
Staff Director, Senate Finance Committee, Dirksen Senate Office Building,  
Washington, D.C.

DEAR SENATOR HARTKE: The Trustees of the Elsa U. Pardee Foundation appreciate your invitation to comment on Sections 4940 and 4942 of the Internal Revenue Code.

The 4% excise tax has proven to be excessive and should be adjusted to reflect the actual requirements for auditing foundations. Perhaps the rate should fluctuate with the financial requirements for the purpose of Section 4940. Some have suggested a 2% excise tax as adequate and if a flat rate is more desirable than a fluctuating rate, we recommend a 2% excise tax.

The minimum distribution of net investment income requirements for private foundations should be changed to lower the rate to reflect the actual yearly income of nearly all foundations.

The present rate requires foundations to sell their assets every year in order to meet the pay out requirement. The other choice is to invest the assets in higher paying bonds or Treasury bills which at the present rate of inflation lowers the true value of the assets year after year.

Either choice means over a period of time—foundations are eliminated or severely impaired in their charitable activities.

We do not believe this was the intent of the Tax Reform Act of 1969 as passed by Congress. At least all Congressmen and Senators we have communicated with did not intend the destruction of foundations.

The Tax Reform Act of 1969 and other legislation pertaining to foundations are well constructed and help correct many actual and potential abuses of administering funds for charitable purposes.



After almost four years of experience under the Tax Reform Act of 1969 it is necessary to change the requirements that are excessive and harmful to the long term health of private charity.

Sincerely,

WILLIAM W. ALLEN,  
Vice President and Secretary.

---

THE HOGG FOUNDATION FOR MENTAL HEALTH,  
THE UNIVERSITY OF TEXAS,  
Austin, Tex., November 13, 1974.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations, U.S. Senate,  
Senate Office Building, Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your letter of October 11th and the accompanying material. While I do not have a special statement myself, I do want to let you know how much many of us in foundation work appreciate the initiative which you have taken and the opportunity which you have given representatives of philanthropy to appear before your Committee. You have a very fine grasp of the current problems and are responding in a statesmanlike way.

Sincerely,

ROBERT I. SUTHERLAND.

---

THE JOHN & MARY R. MARKLE FOUNDATION,  
New York, N.Y., November 8, 1974.

HON. VANCE HARTKE,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: Thank you for sending me the two statements on the work of the Senate Subcommittee on Foundations. I want you to know that I think you have outlined a most constructive set of activities for your Subcommittee during the next two years. You are proceeding to investigate important matters to our country in areas in which there is much confusion.

The views of the Subcommittee on the 4% excise tax and minimum distribution requirements are very much in accord with my own and I hope that these ideas can be vigorously pursued so that private foundations will be enabled to carry out their functions more effectively.

With best wishes,  
Sincerely,

LLOYD N. MORRISETT.

---

THE ROBERT WOOD JOHNSON FOUNDATION,  
THE FORRESTAL CENTER,  
Princeton, N.J., November 11, 1974.

HON. VANCE HARTKE,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR HARTKE: Thank you for giving us an opportunity to comment on the proposed agenda of the Senate Subcommittee on Foundations.

Certainly a study and review of the topics outlined in your agenda in conjunction with new data which will be available through the Filer Commission should be undertaken.

In reference to the 4 percent excise tax on investment income (Section 4940), the history and details of which are spelled out so forcibly in your October 1, 1974 statement, calls for immediate action—namely, a reduction of 4 percent to 2 percent. By adjusting this rate, recipients of foundation grants would be the beneficiary of at least \$30,000,000 per year. I would also urge that this revision be made retroactive to January 1, 1974. This relief would come at a time when the need is most urgent and it could offset to a small degree some of the announced cutbacks. This might be particularly helpful at a time when there is considerable public anxiety about inflation and the support of many programs of local or national importance now aided by foundations.

In reference to the payout provision (Section 4942), the study that you requested of the Treasury Department seems essential in arriving at a percent payout which is both fair and reasonable on a diversified investment portfolio. If there are ways in which we can be helpful, please let me know. We appreciate this opportunity to comment on the proposed topics for your hearings.

Sincerely yours,

DAVID E. ROGERS, M.D.

---

HOWARD HEINZ ENDOWMENT,  
Pittsburgh, Pa., November 7, 1974.

HON. VANCE HARTKE,  
U.S. Senator, State Offices, 447 Federal Building, Indianapolis, Ind.

DEAR SENATOR HARTKE: This is to acknowledge the receipt of your recent letter in which you enclosed two excerpts from the Congressional Record, relating to private foundations. I have read them thoroughly and found these two statements to be both highly informative, and thought provoking. Thank you very much for sending them to me.

I very much appreciate the leadership, perceptivity, and concern you have shown as Chairman of the Senate Subcommittee on Foundations. My very best wishes are with you as you continue in this endeavor.

Sincerely yours,

ALFRED W. WISHART, JR.,  
Executive Director.

---

DUKE UNIVERSITY,  
Durham, N.C., November 8, 1974.

SENATOR VANCE HARTKE,  
313 Senate Office Building,  
Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your recent letter with the enclosed views of the Subcommittee on Foundations on the four percent excise tax and the minimum distribution requirements affecting private foundations.

The statement of the Subcommittee presents a clear summary of the legislative history of the excise tax and, in light of subsequent experience, offers persuasive reasons for its reduction. This would free additional funds for the use of foundations in support of research programs and, in my opinion, would clearly serve the public interest. Similarly, it would appear that a re-examination of the minimum distribution requirements is timely and I warmly endorse the Subcommittee recommendations in this regard.

The Subcommittee has conducted an excellent inquiry into these matters and the tentative agenda for the next two years provides further opportunity for the continued appraisal of the role of foundations in our society. I am firmly convinced this is a most constructive role and a vital element in maintaining a proper balance between public and private programs of research.

With best wishes always,

Sincerely,

TERRY SANFORD.

---

LILLY ENDOWMENT, INC.,  
Indianapolis, Ind., November 4, 1974.

SENATOR VANCE HARTKE,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR HARTKE: Your support for a reduction in the excise tax on foundations from four percent to two percent is much appreciated by all who have concern to see the maximum reasonable pay-out of foundation resources for charitable purposes. May your good efforts succeed.

With warm personal wishes,  
Sincerely,

LANDRUM R. BOLLING,  
Executive Vice President.

THE HERBERT H. AND GRACE A. DOW FOUNDATION,  
MIDLAND, MICH., October 31, 1974,

HON. VANCE HARTKE,  
U.S. Senator, Chairman of the Subcommittee on Foundations of the Senate  
Finance Committee, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR HARTKE: In reply to your letter of October 11 to The Herbert H. and Grace A. Dow Foundation of Midland, Michigan, I am pleased to submit the following remarks as President of the Foundation.

My remarks will be directed mainly to the minimum investment return and required pay-out under Section 4942 of the Internal Revenue Code of 1954, as amended.

On behalf of the above Foundation I am in agreement with your statement and remarks delivered in the Senate on Friday, October 4, 1974 to the effect that the setting of the minimum level of charitable expenditures each year often is based upon interest rates and not total composite investment returns. I am also enthusiastically in support of your statement that the equity side of foundation investment policy should be taken into account. The need for some public comment before the setting of the minimum investment standard and pay-out requirement each year by the Secretary of the Treasury is important. All these things are simply endorsements of your report of October 4. What follows is a more particular viewpoint of this Foundation which I trust is shared by many other private foundations whose assets originated with one family and often in one commercial or industrial enterprise.

There are several premises upon which our opinions and remarks to you and your Committee will be based. These premises are:

1. That all private foundations ought to distribute to qualified charitable organizations each year a minimum amount, expressed in terms of their income yield, and that a percentage of six percent of marketable value is too high and unreasonable.

2. That most, if not all, private foundations now have the bulk of their investment assets in common stocks or equities of corporations, and that these in turn are income-producing—albeit not at a level of six percent per year.

3. That all private foundations (excepting only those subject to Section 4943) exercise little, if any, control over the dividend policies of the corporations whose stocks they hold.

4. That the reinvestment of equities yielding less than six percent per annum by all foundations holding them—even if such liquidation were orderly and over a period of time—would seriously disrupt the stock market and further would have no economic purpose.

5. That the liquidation mentioned in assumption 4 next above would arbitrarily penalize those other investors holding shares in the same corporation by driving the price of such shares down to the prejudice of such shareholders who are completely innocent of the cause of the pay-out requirement.

Given the above premises we believe the burden should be on the Government to come forward with justification for the maintenance of a six percent minimum investment return standard on equity investments.

Our main quarrel with the minimum investment return and pay-out requirement of Section 4942 is that it is too arbitrary and cannot be reconciled with economic and market reality today. For example, when corporations were under wage and dividend guidelines not too long ago, equity yield could not be increased and many foundations were caught with stock investments whose dividend yield was decreasing relative to competing investment media. As the yields decreased, so also the stock market prices slipped and in the resulting dilemma the foundation could do nothing but hold on until restraint on dividend increases was released. By the same token, corporations not able to increase their dividends retained more earnings than usual and therefore financed internal growth with these earnings rather than by going into the money markets. Yield from the money markets therefore slipped correspondingly and the foundations were not able to exercise the alternative of reinvestment in interest securities.

Not long after the relaxation of restraints on divided payments, another economic dilemma arose which again demonstrated the artificiality of the minimum investment return requirement. I speak here of the current bifurcation between the low common stock prices in a severe bear market and the record high interest rates obtainable by short term, liquid investments. An analysis of this later phenomenon shows how reverse attributes from the above can

work the same unjust result on foundations hobbled by a minimum investment return. Thus, currently industrial corporations having low market prices (but no restraint on dividend payments) cannot feasibly go to the money markets by selling their stock. Many attempts to raise corporate capital have been voluntarily aborted by boards of directors who see the terrible cost of dilution of equity were they to float a stock issue in today's market. The alternative is to compete for bank loans or to scramble for funds by the issuance of corporate debentures. Interest rates are thus driven up drastically, and the shorter the duration of the debt instrument the greater its attractiveness to investors. Under these market conditions, all foundations who wish to insure future compliance with the minimum investment return would be in the short term government notes market bidding against each other for debt instruments with one to seven years maturity. I submit that this is not a prudent way for foundation trustees to invest monies dedicated to charitable purposes. Short term investments by foundations, not necessarily in government notes, but in such other instruments as commercial paper and national agency bonds is nothing short of speculation—not speculation in investment quality, but certainly in yield rates and their future. The means of maintaining a high return by private foundation trustees therefore swallows the end—the substantive investigation of charitable needs in the private sector.

Moreover, the cause of the severe decline in the stock market is not of the private foundations' holding equity investments should bear the penalty for international monetary ills, tremendous competition for liquid investments by the Arabian countries, and domestic corporate earnings decline caused by cost-push inflation. I might add that the fact that market prices of stocks have fallen does not mean that the minimum investment return on these stocks necessarily will rise. Taking the private utility industry as an example, we have seen a severe attrition in utility stock prices all over the country, but at the same time a number of very fine utilities have omitted their dividend payments. Utilities, at the time of passage of the 1969 Tax Reform Act, were the darlings of investors seeking high dividend yields.

The upshot of the above economic situation which our nation is enduring at present is that corporations with quality equity shares must retain earnings for internal expansion and growth rather than go out into the money markets and pay fiscatory interest rates for equivalent dollars. The retention of much greater earnings naturally reduces those earnings available for dividend pay-out. We feel the cause of private foundations, private charity, and indeed the country itself is better served by this method of expanding our industrial base, and that the cause of rampant inflation is precisely the bidding for outside dollars which would take place were corporations not in a position to retain increased earnings.

For all of the above reasons we favor the repeal of any minimum investment return or pay-out standard as it would apply to the private equity investments of foundations. If a particular corporate stock held by a foundation paid no dividends whatsoever, we certainly would feel that a de minimis rule would be appropriate to avoid those private foundations seeking to accumulate capital growth. All foundations would—even if our views were to hold—be required to pay out all net income received from dividends. Since the vast preponderance of corporations have experienced steady if not dramatic dividend increases in the past decade, it would seem that the purposes of private charity would still be served by such a requirement.

While the main thrust of my remarks is directed at the minimum percentage pay-out requirement imposed on private foundations, I cannot help but note in passing the undue burden of the present four percent excise tax. It has come to my attention from remarks by other members of your Committee as well as by other committees that this tax is producing far more revenue than is needed to police, audit and examine the compliance of private foundations with the Tax Reform Act of 1969. Without denying the need for audit and examination on a regular basis, I respectfully submit that lowering the excise tax to the amount required to defray such expenses would cause it to be less a tax on charity and more an expense caused by charitable activities. The figure of two percent has been mentioned as an alternative rate, and I respectfully submit that if this is the amount of expense caused by supervision of private foundations, the levy should be lowered to such amount.

I wish to thank you and the members of your committee for the opportunity to present these views. It is not our wish to consume the Committee's time by

appearing personally to give testimony or to read these views before the Committee, but we would respectfully ask that they be filed and noted together with other communications you will be receiving.

Very truly yours,

HERBERT H. DOW,  
*President.*

E. H. MOORE,  
CERTIFIED PUBLIC ACCOUNTANT,  
*Chicago, Ill., November 4, 1974.*

Senator VANCE HARTKE,  
*Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.*

DEAR HONORABLE SENATOR: Thank you for the two statements relative to the planned activities of your committee.

The following comments relate to the items I consider most significant and in need of change that are covered in your Series No. 1 Agenda. I find Series No. 2 of less importance.

(1) The 4% tax on Investment Income should be reduced. Even the Treasury Department recommends a reduction of this tax. The original purpose was to support the cost of policing foundations and not to provide surplus funds to cover costs of other IRS activities. Cost of policing other exempt activities should not be borne by foundations. In addition, I suggest that foundations with less than \$100 tax be exempted.

(2) The minimum payout provisions are one of the features of the 1969 Act which I believe is advisable, even though unreasonable accumulation was improper prior to the 1969 Act. However, the percentage required should not be allowed to rise too high.

(3) The present restrictive rules on grants to individuals for education practically eliminate such expenditures except by the larger, highly organized foundations.

(4) The technical requirement of public notice is an additional administration requirement which I cannot see is justifiable.

(5) The restrictions placed on gifts of appreciated property should be removed. This provision of the 1969 Act has almost stopped creation of foundations and the addition of funds to those in existence. This has and will eliminate many contributions that individuals would otherwise have made. A definite step in the wrong direction.

I think it is significant to consider that this 1969 Act was passed after much publicity about some isolated abuses (which should have been prevented by the IRS under then existing laws) and that your committee has now received a "mere handful of comments suggesting abuses".

The 1969 Act has over-reacted and its penalty and punitive provisions should be modified. An innocent violation invoking these penalty provisions can easily arise because of the complicated law. The layman and even the professional who is not an expert in the field will have great difficulty in not violating some provisions inadvertently.

Yours truly,

E. H. MOORE.

TILLINGHAST, COLLINS & GRAHAM,  
COUNSELORS AT LAW,  
*Providence, R.I., November 6, 1974.*

HON. VANCE HARTKE,  
*U.S. Senate, Committee on Finance,  
Washington, D.C.*

DEAR SENATOR HARTKE: Many thanks for the copy of the Subcommittee report on foundations which I read with interest. It seems to me that your conclusions were eminently sensible and most perceptive.

Also, I very much appreciate the invitation to appear before the Subcommittee on November 25 and 26 when it explores the impact of the current economic crisis on foundations and the recipients of foundation grants. As Chairman of the Board of Rhode Island School of Design, and Vice Chairman of the United Way

of America, I am deeply concerned by the possible impact of decreasing grants on the beneficiaries. Our Centennial Fund at the College is virtually at a standstill, and foundations which we had every reason to hope would support us are obviously feeling the pinch.

Unfortunately, I find it impossible to arrange my schedule for the 26th, and will have some difficulty clearing the 25th as well. If I am able to do so, I will be in touch with you very shortly. Meanwhile, with best personal regards and best wishes, I remain,

Sincerely,

BAYARD EWING.

---

ALFRED P. SLOAN FOUNDATION,  
New York, N.Y., November 6, 1974.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR HARTKE: I have read with interest the material that accompanied your letter of October 11, 1974, to Mr. William Mebane, our secretary-treasurer. I appreciate very much knowing the thoughts and plans of your subcommittee.

I am encouraged by your evident support of certain important principles which underlie the effective operation of private philanthropies. I have a special concern that support of scholarship, research, the arts, and the general benevolence be available from a wide variety of sources, private and public, with the widest possible spectrum represented so that there may emerge the widest possible range of innovation and creativity. There is need for a more general recognition of the fact that the private foundation is an extremely important part of our free enterprise system.

These comments may not be sufficiently specific for your immediate requirements, but I think they do address themselves to the underlying principles.

Sincerely yours,

NILS Y. WESSELL.

---

THE CLARK FOUNDATION,  
Dallas, Tex., November 5, 1974.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: Reference your letter of October 11, 1974, the views of The Clark Foundation, with the exception of the comments outlined below, will be fully expressed by the Council on Foundations spokesman who is scheduled to appear before your Subcommittee at the time of your hearing.

1. The Treasury Department makes a good case for the reduction of the excise tax from 4% to 2% and we concur. I would add one additional point. The cost of the audits should and no doubt will decrease significantly as the Internal Revenue Service gains experience in the tax exempt field.

2. The Clark Foundation feels that the minimum payout (see 4942) is fair and reasonable and we anticipate no problem with compliance. We feel that minimum payout recognizes "Fair Market Value" which is an assist during depressed times and we offer no objection to making distribution of portfolio appreciation during bull markets. In addition, this requires foundations to think in terms of balanced portfolios between debt and equity securities to mollify the effect of bear and bull markets.

The Clark Foundation appreciates this opportunity to submit the above comments and we respectfully request your continued fair and impartial support of "Private Foundations" as serving a vital role in our pluralistic society.

Sincerely,

COL. WALTER KERBEL, USAF (RET.),  
Executive Secretary.

SCHOLTEN & FANT,  
ATTORNEYS AT LAW,  
Grand Haven, Mich., November 5, 1974.

HON. VANCE HARTKE,  
U.S. Senate Office Building,  
Washington, D.C.

DEAR SENATOR HARTKE: Under date of October 11, 1974 you wrote to The Loutit Foundation, of which I am a trustee, requesting comments or suggestions.

The Board of Trustees of The Loutit Foundation has requested that I respond to your letter.

This foundation is in favor of reducing the excise tax from 4% to 2%. We believe that the tax should bear a direct relationship to the cost of checking and policing and should not be a tax merely for the purpose of a tax.

I believe it is most difficult to set a uniform standard of income and thus require distributions to meet that standard. The exceptional cases to such a rule would probably be greater than those that could abide by the rule itself. As an example, The Loutit Foundation, over a period of time, acquired waterfront property in the City of Grand Haven and then developed the property by installing a revetment and landscaped the property preparatory to making disposition. All this was done for the purpose of coordinating an orderly development of the waterfront property and to clean up an unsightly situation. Needless to say, this is a non-income producing investment and will remain so until such time as we are able to dispose of the property in an orderly fashion and re-invest the proceeds. I believe that to be one example that would impose a hardship on a foundation by using the income factor rule and I am sure that there can be many other similar types of cases.

I am enclosing herewith a copy of the 6th published report of the Loutit Foundation and I would like to call your attention particularly to the statement of policy and objectives on the first page. There is one policy statement which might be of interest to you and which is not spelled out in the documents creating the foundation, and that has to do with our own policy of termination.

Very truly yours,

HARVEY L. SCHOLTEN.

ELLEN WINSTON,  
Raleigh, N.C., October 28, 1974.

Senator VANCE HARTKE,  
U.S. Senate, Committee on Commerce,  
Washington, D.C.

DEAR SENATOR HARTKE: I appreciate your sending me the reprints from the Congressional Record with regard to the Senate Subcommittee on Foundations. I am especially interested since I have been doing some work with the Filer Commission.

I am writing because of my concern over the omission of social welfare from Series No. 2 in the report of activities which appeared in the Congressional Record on Thursday, September 26, 1974. In the list of ten areas under Series No. 2 there is no real attention given to social welfare. Yet our activities in the voluntary sector with respect to children and families are of great importance and have depended for many years upon substantial understanding of and support from foundations and other charitable sources. My own recent studies reflect the relative paucity of support for this area as contrasted with health and education, contrary I am sure to the public impression that social welfare is a major beneficiary of charitable funds.

We certainly must be concerned about the social welfare needs of the larger segment of our population which will not qualify for services related to income eligibility. Also, the private sector has provided leadership over the years in standard setting, a major concern in relation to all social services. As in other fields, we are deeply concerned with respect to protection of pluralism and the right of choice. Thus there are many reasons why I sincerely hope that your Committee will give substantial attention to the broad field of social services as you conduct further studies.

Sincerely,

ELLEN WINSTON.

THE LUMPKIN FOUNDATION,  
Mattoon, Ill., October 31, 1974.

Hon. VANCE HARTKE,  
U.S. Senate, Senate Office Building,  
Washington, D.C.

DEAR SENATOR HARTKE: I have reviewed your letter to Mr. McGeorge Bundy dated September 23, 1974, and am pleased to note your concern in respect to private foundations.

It is indeed true that a diminution of \$2 billion in grants would be "a tragedy for the cause of social and economic justice."

The present level of grants is, of course, not solely determined by the "impact which the current economic situation is having on private foundations."

The punitive character of the Tax Reform Bill of 1969, as it relates to private foundations, is a matter of special concern to those foundations and their management.

Shouldn't the hearings of the Senate Subcommittee on Foundations give special attention to the ultimate effect tax legislation is having on private foundations and the activities they support?

Respectfully yours,

R. A. LUMPKIN.

---

UNION BANK AND TRUST CO.,  
NATIONAL ASSOCIATION.  
Grand Rapids, Mich., November 1, 1974.

Senator VANCE HARTKE,  
313 Old Senate Office Building,  
Washington, D.C.

DEAR SENATOR HARTKE: As a Trustee of the Grand Rapids Foundation I learned of your notice for hearings on the subject of foundations, scheduled for November 25th and 26th.

Our family has had an interest in the establishment of a private family foundation and as a matter of fact, in June, 1973, we had a meeting with Representative Mills on this subject. This meeting was arranged by President Ford when he was then House Majority Leader.

The 1969 Tax Reform Act was far too severe and because of this, there have been very few private foundations established since then. Mr. L. William Seidman, who was my tax consultant and who was with me at the meeting with Representative Mills, is, as you know, Economic Advisor to President Ford and is well informed on the subject of public and private foundations and the problems and restrictions that are in effect today. Specifically, there are at least three difficult regulations; the required payout provision, the federal income tax, and the 20% voting stock limitation investment in any one company and the related divestiture rule of five years.

A great deal can be done by Congress to change the severity of the 1969 tax laws and thereby encourage the continuation of private foundations as well as encourage the establishment of new foundations.

Cordially,

EDWARD J. FREY.

---

THE JACKSON FOUNDATION  
Jackson, Mich., November 1, 1974.

Senator VANCE HARTKE,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your letter of October 11, 1974. The Jackson Foundation is a community Foundation, not a private foundation, but is, of course, an exempt organization.

First, may I say that it would be very helpful to have the Treasury Department complete and publish its regulations with respect to the community foundations. These have been "in the mill" for a long time, and it would be helpful to know exactly the requirements which are to be met.

Although we are not subject to the four percent excise tax and the minimum distribution requirements, it is the writer's personal opinion that the excise tax



on private foundations should be reduced to a figure comparable to the cost of administration by the Internal Revenue Service and that the minimum distribution requirements should also be carefully considered.

Sincerely,

F. W. CORWIN,  
*Executive-Secretary.*

---

CROSBY, GUENZEL, DAVIS, KESSNER & KUESTER,  
*Lincoln, Nebr., November 4, 1974.*

Senator VANCE HARTKE,  
*313 Senate Office Building,  
Washington, D.C.*

DEAR SENATOR HARTKE: As one of the witnesses appearing before your Subcommittee on the matter of foundations I was most interested in reading the complete statement issued by such Subcommittee. You have performed an exceptional service to the country in summing up the many hours of testimony into a relatively brief statement covering the material matters lucidly. Certainly any person reading this statement must gain a clearer understanding of the foundation problems covered therein.

As my primary interest is in the area of community foundations I am hopeful that the projected hearings on such foundations will produce an equally effective statement. I am hopeful that such hearings will be scheduled in the near future. I mention this only because the Regulations on community foundations, the non-issuance of which I complained about in my testimony to your Subcommittee in October of 1973, still remain unissued. It is difficult for me to understand this treatment of these important public foundations by the Service. Perhaps your Subcommittee can be as successful in dealing with the problems of community foundations as in your work to date.

Yours truly,

ROBERT C. GUENZEL.

---

THE DANFORTH FOUNDATION,  
*St. Louis, Mo., November 5, 1974.*

Hon. VANCE HARTKE,  
*Chairman, Subcommittee on Foundations,  
Washington, D.C.*

DEAR SENATOR HARTKE: I agree with your position of reducing the four percent excise tax on Foundations to two percent, the amount reported by the Internal Revenue Service as an appropriate amount to monitor Foundations.

I appreciate your leadership, and that of others, to the issue. I am among those who feel it is equitable for Foundations to pay for the cost of being monitored, but that such a tax to increase revenue of the Federal Government is not appropriate, for it challenges the entire structure of tax-free philanthropy.

Sincerely,

GENE L. SCHWILCK,  
*President.*

---

COLUMBIA UNIVERSITY IN THE CITY OF NEW YORK,  
DEPARTMENT OF ECONOMICS,  
*New York, N.Y., October 30, 1974.*

Senator VANCE HARTKE,  
*U.S. Congress,  
Washington, D.C.*

DEAR SENATOR HARTKE: You were good to send me the material from the Congressional Record containing the reports of the Subcommittee on Foundations. Within a short time I shall hope to send my comments. The subject is one in which I have been interested for some time. Needless to say, I am anxious to do whatever I can to contribute to the best governmental policy possible.

Respectfully yours,

C. LOWELL HARRISS,  
*Professor of Economics.*

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,  
New York, N.Y., October 29, 1974.

Hon. VANCE HARTKE,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR HARTKE: Thank you for the Congressional Record material and the data from the Senate Subcommittee on Foundations which you sent to me earlier this month.

It has always been my feeling that the Tax Reform Act of 1969 as it relates to foundations had imposed restrictions which although well intended, adversely affected the social welfare efforts of a good many foundations. This occurred largely because of the diversion of foundation grants to tax revenues. The level of funds derived from the excise taxes were many times more than the costs of the units designated to administer that part of the code which deals with foundations and tax-exempt organizations.

There have been many foundations which have terminated voluntarily and a good many more, such as our own, which will terminate shortly. The unfair burden imposed by the tax as well as those elements of the code which threaten penalties for certain modes of behavior have limited the ability of many foundations to seek out and find worthy causes.

I personally appreciate your stance on this important philanthropic matter.

Very truly yours,

THOMAS B. JONES.

KING & SPALDING,  
Atlanta, Ga., October 31, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: This will acknowledge your letter of October 11, 1974 with its enclosures.

I have read the statements concerning the 4% excise tax and the minimum distribution from private foundations and found them to be most interesting.

As you may know, our firm represents a substantial group of private foundations in the Atlanta, Georgia area. Our clients uniformly feel that the 4% excise tax discriminates unfairly against private foundations, since no comparable tax is assessed against other exempt organizations, and that the tax reduces funds which would otherwise benefit worthy charitable grantees.

We also feel that the concept of the minimum investment return, linked as it is to fair market value, is inappropriate. If the investments of a private foundation are successful, so that the fair market value of the security in question rises on the market, the foundation must pay out a larger amount from its portfolio. This increased distribution cannot be expected to come from income, since cash dividends frequently do not reflect increases in fair market value—the market places a value on prospective earnings, rather than current earnings. Then, too, assuming a 6% minimum investment return, any time a common stock sells at a multiple of more than 16 times earnings (as has frequently been the case since the Tax Reform Act was enacted), a company would have to pay out more than its current earnings in dividends to permit a foundation to meet the minimum investment return. In fact, where such is the case, the distribution rules require a divestiture of corpus, which was obviously the intent of some members of Congress back in 1969. If this is the intent of Congress, we feel that it ought to be expressed directly, rather than indirectly, and that the judgment should be made on the grounds of whether private foundations are viable elements of our national community, or not.

All of us here very much appreciate your continued interest in these problems, and if we can be of help to you in any way, please let us know.

Sincerely yours,

JOHN A. WALLACE.

PEPPER HAMILTON & SCHEETZ,  
ATTORNEYS AT LAW,  
Philadelphia, Pa., October 22, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
313 Old Senate Office Building, Washington, D.C.

DEAR SENATOR HARTKE: This is to acknowledge with thanks your letter of October 11 enclosing excerpts from the Congressional Record of September 26 and October 4. Your recommendation that the Internal Revenue Service prepare to furnish better statistical information is completely appropriate. It is most unnecessary that efforts at analysis be based upon guess work (however conscientious) when it is possible to expand the knowledge that we have.

I read with particular interest the portion of your report relating to "determination of the applicable percentage." I think the analysis of the Senate floor action emphasizing a statement by Senator Curtis is a bit unfair to Senator Percy. While Senator Curtis may have accurately described the consequence of Senator Percy's amendment, I do not believe Senator Percy's intent should be inferred from the statement. I recall that Senator Percy denied that the percentage would lead to the death of foundations but rather would require distribution of a portion of unrealized capital gains of the well-managed foundation without requiring a contraction of the well-managed foundation. If we look at the figures for 1968 (which would have been the latest available at the time of the 1969 debate) we will see that the total return (dividends plus principal appreciation) reduced by inflation would be about 6%. Our analysis indicates this is a bit higher than the long-term analysis would justify (perhaps by 1½%) but still the principle that Senator Percy was proposing had statistical support in the report issued by the Peterson Commission shortly before.

What we have seen in the last two years is a dramatic increase in interest rates and a reversal of stock growth. Thus the Treasury Department may feel that present statute requires an increase in the 6% factor while at the same time the foundation (most of whom have experience paralleling that of the stock market) will have suffered substantial depletions in corpus values. I believe a fair reading of your report is that the statute has an improper formula for adjusting the pay-out because it will require the *largest* invasions of corpus at a time when principal values are *contracting* and the *smallest* invasion of corpus when principal values are *increasing*. I won't burden this letter with our detailed analysis that led us to this conclusion but would be glad to discuss it with you or a member of your staff.

The 1969 Act represented a tremendous legislative effort within a very brief span of time and it is not surprising that there are some things that need correction to achieve the result that Congress had in mind. We hope that action of your Subcommittee can result in some of these problems coming to the attention of the Senate in the near future.

Sincerely,

JOHN B. HUFFAKER.

---

KIRKPATRICK,  
Oklahoma City, Okla., October 31, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR HARTKE: While we are not a large Foundation, nationally speaking, there is no Foundation more important than ours in the welfare of our community here in Oklahoma City.

We are sending the enclosed letter to approximately two hundred recipients of our charities in the past. I am sure that these institutions would be interested in supporting our position. However, I doubt if they were aware that the 1969 Act would be as damaging as it has been.

Sincerely,

JOHN E. KIRKPATRICK.

OCTOBER 31, 1974.

ALL SOULS EPISCOPAL CHURCH,  
6400 North Pennsylvania  
Oklahoma City, Okla.

GENTLEMEN: It is only fair to let you know that the value of our investments have decreased to such an extent that we will have much less money for distribution in the future.

Under the Tax Law of 1969, we are taxed on our capital investments and therefore we cannot build up our Foundation in order to increase our income. You are therefore advised to go elsewhere for your support in the future.

Without doubt our private foundations are on the way to extinction. In so far as we know, few, if any, of our past recipients have turned a hand to influence their congressmen to preserve this source of their support.

Sincerely,

JOHN E. KIRKPATRICK.

COHEN AND URETZ,  
Washington, D.C., October 28, 1974.

HON. VANCE HARTKE,  
U.S. Senate,  
Washington, D.C.

DEAR VANCE: Thank you for sending me the material on the tentative agenda for your Subcommittee on Foundations. It shows a good deal of the work which you and your staff have been involved in for the past two years and points the way to needed work in the next session. I congratulate you for your insights into both the public's interest and the country's interest. They should both be the same—but are not always. It is good to air the diverse views on the subjects outlined so we can develop sound policy.

I commend you and the committee for your efforts. I would also suggest that someone ought to be looking at the problems of charities and other exempt organizations with the same vigor you are putting into foundations. This is a very neglected area of the law.

If I can help you with any of your topics, do not hesitate to call on me.

Best regards,  
Sincerely,

SHELDON S. COHEN.

COUNCIL FOR AMERICAN PRIVATE EDUCATION,  
Washington, D.C., October 23, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your letter of October 11 and its enclosures. I appreciate your interest in keeping us informed concerning the activities of the Senate Subcommittee on Foundations. Our interest in this is, as you've indicated, very real.

As we have reactions to these and other materials you are good enough to send along, or as we have thoughts with regard to other matters affecting tax-exempt organizations, we will surely be in touch with you. We are most appreciative of your open invitation to do so.

Sincerely yours,

ROBERT L. LAMBORN,  
Executive Director.

INTERNATIONAL BUSINESS MACHINES CORPORATION,  
Armonk, N.Y., October 24, 1974.

HON. VANCE HARTKE,  
The U.S. Senate, Washington, D.C.

DEAR SIR: Thank you for your recent letter which encloses the two statements relating to private foundations and other exempt organizations. While I am much interested in the work of your Subcommittee on Foundations and ap-

preciative of your requesting my opinion, I have no direct experience with foundations nor does our corporation maintain such an organization. On this basis, I do not feel really qualified to provide any significant comments or suggestions.

Best wishes for the successful efforts of your Subcommittee to deal with these complex matters.

Sincerely,

THOMAS R. HORTON.

---

THE CHURCH OF JESUS CHRIST OF LATTER-DAY SAINTS,  
THE COUNCIL OF THE TWELVE,  
Salt Lake City, Utah, October 24, 1974.

HON. VANCE HARTKE,  
The U.S. Senate, Washington, D.C.

DEAR MR. SENATOR: Your letter of October 11, 1974, was read with interest. My participation in the subcommittee recently in Washington, D.C. provided background and a continuing concern in the field of taxation and exempt organizations.

The concern of myself and the Church that I represent deals primarily with exempt organizations and not foundations. We feel that tax consideration should be given when assistance is rendered directly to people and for certain preparations that are made to render assistance to people in cases of emergency.

The Tax Reform Act of 1969 declared these and other similar objectives subject to "unrelated business taxable income". I feel strongly that the government should not penalize an organization for trying to help people help themselves as opposed to encouraging them to participate in the dole. Any time a person can be returned to independence and industry, the nation, as well as the family, will be benefited. To tax activities that accomplish these goals seems to be inconsistent.

Again, thank you very much for the information; and we would be most happy to share our views, especially on the tax exempt organizations and unrelated business taxes, whenever possible.

Sincerely yours,

ELDER JOHN H. VANDENBERG,  
Assistant to the Council of the Twelve.

---

SAMUEL S. FELS FUND,  
Philadelphia, Pa., October 30, 1974.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations, Senate Finance Committee, U.S. Senate,  
Washington, D.C.

DEAR SENATOR HARTKE: We received on October 21 your letter dated October 11 concerning two statements on the activities of the Senate Subcommittee on Foundations. I was very pleased to receive these statements, since I have read frequently about the work of your subcommittee and your own deep interest in the problems of grant-making and charitable organizations.

At your invitation, may I provide the following comment on the materials you sent us concerning tax exempt organizations.

Your statement that you are concerned about the impact of the present economic crises on foundations merits the most urgent consideration by leaders concerned with philanthropy in our country. The increased commitment of resources during years of prosperity, which commitment was broadly encouraged by Congressional action in the Tax Reform Act of 1969, led a great many foundations and public charities to expend a higher proportion of their resources than ever before. The subsequent disastrous decline in the stock market has placed many foundations in a period of crisis. This is especially true of smaller public charities and foundations whose assets have been reduced drastically by the average decline of 44% in the stock market since the end of 1972. Congress certainly could not have foreseen the precipitous decline in stocks, but its impact has been grave. Foundations and public charities are now faced with the problem of meeting previous commitments from vastly depleted resources.

Those foundations that have been most faithful to their obligations and which have commitments of long standing are particularly affected. The Samuel S. Fels Fund, for instance, has for 35 years supported two scientific institutions and a university graduate center, and these obligations now require very heavy expenditures from principal. Such very serious conditions require that persons in positions of leadership think deeply about the future of philanthropy in this country. Not only are foundations and public charities seriously affected, but all of those very worthwhile activities obtaining support from such sources are also imperiled.

I believe that your subcommittee has a very difficult task, one that requires great wisdom as well as diligent mastery of complex facts. The tradition of voluntarism is in danger, and that free giving of wealth that has characterized America is also in danger. I can only hope that your subcommittee will return to its Congressional responsibilities with an even more acute concern in this time of grim economic dislocation.

Sincerely yours,

NOCHEM S. WINNET,  
*President.*

---

THE HALLMARK EDUCATIONAL FOUNDATION,  
*Kansas City, Mo., November 1, 1974.*

Senator VANCE HARTKE,  
*U.S. Senate,  
Washington, D.C.*

DEAR SENATOR HARTKE: Thanks so much for sending me copies of the *Congressional Record* containing the activities of your Subcommittee on Foundations.

As I am sure you are aware, the 1969 Tax Act imposed a number of burdens upon foundations such as ours who are trying to promote worthwhile charitable enterprise. I am sure you are also more aware than I that the few instances of malfeasance by some foundations does not represent what has been going on in the great majority of charitable organizations and it is unfortunate that the action of a few could have such a profound affect on all the rest.

As a beginning, we hope that you will be successful in reducing the 4% excise tax to 2% or some other figure which more nearly reflects the administrative costs of supervising the foundations and enforcing the 1969 Act. Best of luck in your efforts.

Yours very truly,

ROBERT H. BUSLER,  
*Secretary-Treasurer.*

---

CARNEGIE CORPORATION OF NEW YORK,  
*New York, N.Y., November 1, 1974.*

Senator VANCE HARTKE,  
*Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.*

DEAR SENATOR HARTKE: Thank you so much for sending me the two statements regarding the future agenda of the Subcommittee on Foundations and the view of the Subcommittee on the 4 percent excise tax and the minimum distribution requirements which affect foundations.

I will look forward to reading them with great interest.

With best wishes,

ELI EVANS.

---

THE PHILADELPHIA FOUNDATION,  
*Philadelphia, Pa., October 24, 1974.*

Senator VANCE HARTKE,  
*Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.*

DEAR SENATOR HARTKE: Thank you for your kindness in furnishing us with material relating to private foundations and other tax exempt organizations.

Even though ours is a community trust and therefore not considered as a private foundation, I read the statements you included in your letter of October

11, 1974 with great interest. However, since the matter of the four per cent excise tax and minimum distribution requirements do not directly affect The Philadelphia Foundation, I think it might be well for us to refrain from comment on these matters.

Again, thank you for your thoughtfulness, and I hope you will continue to keep us informed of all developments in this area.

Kindest regards.

Sincerely,

SIDNEY N. REPPLIER,  
*Director.*

---

JAMES H. CUMMINGS FOUNDATION, INC.,  
*Buffalo, N.Y., October 23, 1974.*

VANCE HARTKE,  
*Chairman, Subcommittee on Foundations, State Offices, 447 Federal Building, Indianapolis, Ind.*

DEAR SENATOR: Thank you for your letter of October 11th, with which were enclosed two statements appearing in the Congressional Record. We were glad to have this information, which has been carefully reviewed.

Ours is a relatively small foundation, as you will observe from the enclosed Annual Report. It will also be noted we are a testamentary foundation and our directors continue to strive to honor the wishes of the testator.

We are also grateful for your views and that of your subcommittee on foundations, concerning the present 4% excise tax which, it would appear, could be reduced to some extent and thus benefit prospective grantees to a great extent.

Sincerely yours,

F. TAYLOR ROOT,  
*Executive Director.*

---

PAUL R. HAAS,  
*Corpus Christi, Tex., October 28, 1974.*

HON. VANCE HARTKE,  
*U.S. Senate,  
Washington, D.C.*

DEAR SENATOR HARTKE: Thank you for sending me the statement outlining the activities of the Senate Subcommittee on Foundations and views of the subcommittee on the 4 percent excise tax. I think the statements represent a superior condensation of a great mass of material.

I am particularly pleased that you think it worthwhile to continue the hearings—and your breakdown of matters to discuss is in sufficient detail so that input can specifically relate to an applicable hearing rather than trying to cover the entire subject matter. It should also make it possible for appearances to be requested with a good degree of specificity so that both the time of the subcommittee and the time of the witness can be most efficiently utilized.

Sincerely,

PAUL HAAS.

---

HAWKINS, ASH, BAPTIE & COMPANY,  
CERTIFIED PUBLIC ACCOUNTANTS,  
*La Crosse, Wis., October 29, 1974.*

HON. VANCE HARTKE,  
*U.S. Senate,  
Chairman, Subcommittee on Foundations,  
Committee on Finance,  
Washington, D.C.*

DEAR SENATOR HARTKE: The members of our firm were pleased to receive your letter of October 11 and the related material on certain activities of your subcommittee.

We have among our clientele a number of private foundations. You may be assured that the conclusion of your subcommittee to reduce the excise tax to 2% from 4% is unanimously endorsed.

The recommendation that Section 492 be amended to give the public an opportunity to comment on proposed changes in the applicable percentage also receives hearty endorsement.

I think that all of us are concerned that there have been abuses in the field of exempt organizations as there have been abuses in other fields. While the 1964 Tax Reform Act appears to be very effective in eliminating such abuses, it also has placed considerable burdens on relatively small private foundations in complying with the new requirements. Anything that can be done by your subcommittee to alleviate these burdens while not weakening the sound purposes of the Tax Reform Act will most certainly be welcomed by many people.

Sincerely,

JAMES O. ASH.

---

OAKLAND SCOTTISH RITE,  
SCAIFE SCHOLARSHIP FOUNDATION,  
Oakland, Calif., October 21, 1974.

Senator VANCE HARTKE,  
Senate Committee on Finance, Chairman, Subcommittee on Foundations, 313  
Old Senate Office Building, Washington, D.C.

DEAR SENATOR HARTKE: We were pleased to learn of the progress being made toward reducing the 4% excise tax now being applied to foundations to 2% or hopefully even less than that.

We have sent information to our California senators in which we were trying to get their understanding of the need for a separate category for the purely philanthropic foundations who have no overhead, operate no businesses, own no real estate, and pay out practically 100% of all income to their purposes which in our case is scholarships to needy and worthy college students.

Our office is manned completely by volunteers so that we have practically no overhead except the necessary postage, letterhead, envelopes, clerical assistance and other supply expenses. This office reaches out to all of the high schools in the central and northern part of our state to search for seniors who should go on to college but who might not because of limited or sometimes completely missing family resources. This foundation, in order to pay the 4% excise tax to the federal government, has had to eliminate seven students who otherwise would have received our aid. This amount seems to us to be completely out of line.

When our legislators started their war against foundations, they used a general approach as if all foundations are alike and were equally guilty of misuse of funds for anyone of a variety of purposes. A careful examination of the situation at that time and certainly a careful examination of the situation today would reveal to you many foundations, like our own, which are purely philanthropic, have no political, financial or other activities and which are doing a great job of helping students with college expenses. In our case, this year marks the point at which we will be assisting our 1,000th student and also during this year we will be at the point of having given one million dollars of aid to students all of which was earned from the income of bequests and gifts which we managed very carefully to produce an average income of about 7% this year. We pay out 100% of our income every year.

If further information would be helpful to your committee, we would be more than happy to supply it.

Sincerely,

F. C. MICHELL,  
Secretary.

---

CENTER FOR ADVANCED STUDY IN THE BEHAVIORAL SCIENCES,  
Stanford, Calif., October 29, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: Following the suggestion in your letter of October 11th that I send comments "on any subject which affects tax exempt organizations," I enclose a recent paper on budget alternatives to the tax write off for providing governmental support of charity.



Both the interests of charitable organizations and of budget and tax reform could be served by adopting the Donor-directed Automatic Contribution Bonus.

Thank you for your interest.

Sincerely,

AARON WILDAVSKY.

COMMUNITY SERVICE SOCIETY,  
New York, N.Y., October 25, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: I appreciate your letter of October 11, 1974 asking my views on your two recent statements regarding the activities and views of the Senate Subcommittee on Foundations. While I remain keenly interested in matters relating to foundations and charitable corporations, I have not been able to keep informed of legislative developments regarding the tax aspects of *private* foundations.

On the other hand, I share the concern of many people regarding the current restrictions and possible future restrictions on the legislative activities of charitable corporations under 501(c)(3) of the Internal Revenue Code. I feel that charitable corporations represent a valuable resource to this country, and the Congress ought to encourage them to present their views on social issues in the legislatures.

Recently, there has been an effort within the House Ways and Means Committee to address this problem as part of this year's Tax Reform package. The bill is HR 12037 and known as the "Conable Bill." However it was recently withdrawn by its sponsor when, after a drafting session by the Ways and Means staff, some of the provisions became overly restrictive. As a result we are not optimistic that this problem will be met during the current session of Congress. There has been discussion of perhaps amending the Tax Reform Bill when it is sent to the Senate and then attempting to resolve the differences in conference. If momentum develops around this alternative, I would be happy to communicate with you more specifically on these issues.

Very sincerely,

ALVIN L. SCHORR.

EDWARD J. FLYNN,  
Los Angeles, Calif., October 28, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations, U.S. Senate, Senate Office Building,  
Washington, D.C.

DEAR SENATOR HARTKE: You are to be commended for your continuing efforts on the matter of Foundations and Charities, for they will prove to be major entities on the national scene during the next decade, as our economy shifts.

As a business consultant to Foundations and Colleges, I can see the tremendous value of the material which will be developed from your hearings. Most foundation executives and trustees are also of this opinion, although many would like to see some changes in the excise tax and I would agree. I would suspect that 2% would provide enough funds for agents based on what has been collected to date.

While foundations have been active in alerting the public to their activities, I think more needs to be done in this direction. It is the second tier of foundations which needs to be alerted to their responsibilities. The first tier is well aware. Hopefully, your hearings will reach down to the second level.

The positive efforts of foundations this year in various fields have been most constructive and helpful. As an observer of their activities for more than twenty years, I think there is genuine progress being made.

Keep up the good work.

Sincerely,

EDWARD J. FLYNN.

THE KRESGE FOUNDATION,  
Troy, Mich., October 23, 1974.

Hon. VANCE HARTKE,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your letter of October 11 which, incidentally, did not reach our offices until October 22; please note our correct address.

We appreciate knowing of the activities of the Senate Subcommittee on Foundations and having the opportunity to comment on the views of the Subcommittee on the 4% excise tax and the minimum distribution requirements affecting private foundations.

On July 11, 1974, William H. Baldwin, President and Chief Executive Officer, sent you this Foundation's view about the excise tax and minimum distribution requirements. A copy of that letter was also sent, on July 12, 1974, to Mr. Michael Stern, Staff Director of the Senate Finance Committee. I am taking the liberty of sending you the enclosed additional copy of Mr. Baldwin's letter.

We would make one additional comment at this time, and that is that we support your Subcommittee's recommendation that IRC Sec. 4942 be amended to give the public an opportunity to comment on proposed changes in the applicable payout percentage.

Sincerely,

ALFRED H. TAYLOR, Jr.,  
Vice President for Administration.

---

THE KRESGE FOUNDATION,  
July 11, 1974.

Senator VANCE HARTKE,  
Senate Office Building,  
Washington, D.C.

DEAR SENATOR HARTKE: You have asked for comments from foundations about Internal Revenue Code Sec. 4940 (4% excise tax) and IRC Sec. 4942 (distributions of income), and we offer the following observations:

(A) As to the 4% excise tax:

Ideally, the 4% excise tax should be replaced by a foundation audit fee based on size of assets which could be similar to fees charged for audits for banks and savings and loan associations. Absent such a possibility, the 4% tax should be reduced to 1% or 2% as to ordinary income. Collections for 1972 and 1973 were far in excess of the cost of audit and both the Treasury Department and Internal Revenue Service agree that this is so. A 1% or 2% excise tax would more than suffice to provide the requisite funds for audit. In addition, it is our strong opinion that the excise tax should be eliminated entirely as to long-term capital gains. For example, on May 15, 1973 we paid a total of \$5,711,190 with respect to the 4% excise tax for calendar year 1972. Of this amount, about \$5,140,000 was attributable to 1972 realized capital gains resulting from a major secondary offering of S. S. Kresge Co. common stock. This secondary distribution was engaged in solely to diversify our holdings and to increase our rate of return since we have never had an excess business holdings problem. The fact is that there are a number of foundations, like ourselves, who are subject to the minimum investment return portions of the Tax Reform Act of 1969 and hold large (but not excess) business holdings which produce a modest dividend. In order to lessen the invasion of corpus occasioned by the pay-out requirements, a number of us had secondary distributions in 1972 and invested the net returns in higher yielding securities. In view of the fact that the 4% excise tax on ordinary income produces an amount which is five to six times the required amount for treasury foundation audits, it seems unduly harsh to our potential foundation beneficiaries to add to that amount. I am sure you understand and know that the lowering of the 4% excise tax rates and the

elimination of the tax on capital gains would not benefit us but our applicants since whatever is not paid in tax would have to be paid out in qualifying distributions.

(B) *As to the pay-out requirements of Sec. 4942:*

We consider that the minimum investment return provision, when coupled to present high inflationary factors, results in unwarranted deterioration of the effective levels of Foundation giving. Having fixed pay-out requirements makes us especially aware of any contraction in the purchasing power we extend by way of grants to our applicants. This Foundation made a study of what would have happened had the maximum 6% pay-out rate been in effect since our beginning in 1924. While there would have been a comparatively modest increase in total grants over the forty-nine year period, the income-producing assets of the Foundation would have been drastically reduced by reason of invading principal to make the required distribution. That there will be a short term increase in benefits to the public is undeniable, but continued application of the present minimum investment return pay-out rates will seriously curtail those benefits for the long term. The answer to this problem, as in the case of the excise tax, is reduction of rate. To be specific, in the year 1972 our appropriations for contributions were about \$29 million and this meant an invasion of corpus in the amount of about \$15,600,000. Similarly, in 1973 our appropriations for contributions were about \$29,700,000 and this meant invading corpus to the amount of approximately \$12,700,000. Obviously, this is particularly distressing at a time when the market is so depressed and inflationary rates are so terrifying.

I hope that you will believe me when I tell you that all the above suggestions, in my opinion, are for the long term interests of charity. As indicated, a reduction of the excise tax rate will be to the benefit of our potential beneficiaries since we will have to pay the money out in any event. Similarly, in my view, the preservation of our corpus will, in years to come, be to the best interest of all charitable organizations. The Foundation's sole donor, Sebastian S. Kresge, titled on a grand scale leaving a personal estate at his death, in 1968, which was only one tenth of the book value of the gifts he made to the Foundation starting in 1924. Appropriations by the Foundation of approximately \$175 million over fifty years amount to benefits which are treble the original gifts and, even in a depressed market, the Foundation's principal assets show an eleven-fold increase over the original donations. Such a long continued enhancement of the generous impulses of one man should, I think, be thoughtfully considered.

I shall be delighted to speak with you or any of your staff members about any of the points which I have raised and to document our point of view. In addition, we will be glad to answer any questions which you or any member of your staff may have about the points which I have raised or any other point with respect to foundations and the 1969 Tax Reform Act.

Sincerely,

WILLIAM H. BALDWIN,  
*President.*

\_\_\_\_\_  
LORD, DAY & LORD,  
New York, N.Y., October 24, 1974.

Hon. VANCE HARTKE,  
*Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.*

DEAR SENATOR HARTKE: I greatly appreciated receiving the two statements relating to private foundations and other exempt organizations that you sent to me with your letter of October 11, 1974. I am very interested in the matters covered by the statements and hope to take advantage of your kind invitation to furnish you my comments or suggestions. I believe that the subcommittee is particularly well constituted to re-examine the place of private foundations in our society and under our tax system and am pleased that the subcommittee is working so effectively with the Filer Commission.

Sincerely yours,

R. PALMER BAKER, Jr.

OFFICE OF THE ATTORNEY GENERAL,  
STATE OF OHIO,  
Columbus, Ohio, October 22, 1974.

Senator VANCE HARTKE,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR HARTKE: Thank you for the information relating to charitable foundations. Our Office is particularly interested in the topics which relate to governmental supervision of foundations, the relationship between foundations and government and activities and practices of public charities.

In connection with the above our Office is in the process of preparing a report for the Filer Commission. As soon as that report is completed, a copy will be made available to your committee. If testimony is required we shall be glad to send a representative.

Very truly yours,

WILLIAM J. BROWN,  
Attorney General.  
JOSEPH M. PAUL,  
Assistant Chief.

---

THE WINSTON-SALEM FOUNDATION,  
Winston-Salem, N.C., October 22, 1974.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations, 313 Old Senate Office Building, U.S.  
Senate, Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your letter enclosing your statement about the four per cent excise tax and pay out provisions for private foundations and the invitation to comment.

I am impressed with the thoroughness with which you are approaching the whole subject of foundations and the public interest. You are obviously trying to get at the facts. While the Winston-Salem Foundation is not a private foundation, we work with a number of them in our area and depend on their grants to help with important community projects. We would not want to see their effectiveness diluted and therefore heartily endorse your conclusion that the four per cent tax should be reduced to two per cent.

Please be sure to let me know when we can be of some service to you or your staff.

Sincerely yours,

SEBASTIAN C. SOMMER,  
Executive Director.

---

EDWIN D. ETHERINGTON,  
Old Lyme, Conn., October 21, 1974.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your October 11th letter and the enclosures related to private foundations.

I always felt that an audit tax at the 4% level was clearly too high. I am glad you have concluded that it should be cut in half. If anything, I would cut it to an even lower amount so that it approximated the actual cost to the IRS for its compliance activities.

As for Section 4942, I agree that more facts are needed and I am glad you intend to press the Treasury Department for information to permit a review by the Congress in early 1975. It is also clearly appropriate that the Section be amended to give the public an opportunity to comment on proposed changes in the applicable pay out percentage.

It seems to me that our "Filer Commission" activities are going along very well and I appreciate, as I know the others will, the comment made in your October statement concerning the work of our Commission.

With kind regards,  
Sincerely,

TED ETHERINGTON.

THE ENVIRONMENTAL FUND,  
Washington, D.C., October 23, 1974.

Hon. VANCE HARTKE,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR HARTKE: Thank you for inviting me to make suggestions relative to the tax laws and the foundations.

As you know, the Tax Reform Act of 1969 was a legislative shambles. The professionals at I.R.S. had been working on it for five years, and they freely concede that they will never figure it out.

This tiny foundation has not been too grievously affected, so far, but some of the things which have hurt us must have hurt others a great deal more. I will mention only two which have recently come to my attention:

We have just experienced an I.R.S. audit. The agent was kind enough to telephone ahead and tell us what documents he wanted to see. When I saw the list I was astonished to find that he had asked to see only copies of documents which had been filed with I.R.S. We gladly supplied the copies when he came, but wouldn't it have been cheaper for the taxpayer if he had stayed in his office and studied the originals? Is this what the 4% tax is for?

The agent found everything in order except that we had not paid a tax on securities which we had sold the same day they were received. This is an operating foundation. All of our income is spent for our corporate purposes. We have no portfolio. According to the statute, such a transaction is nontaxable, but the Treasury Department has ruled that it is, and so we were required to pay a tax on capital gains which we never received. This year, with a falling market, we have suffered modest capital losses even though securities were ordered sold within fifteen minutes of their receipt. Under the present treasury ruling, we will, next year, have to pay a capital *gains* tax on securities which we have sold at a *loss*.

I am neither a lawyer nor an accountant, but this does not seem fair.

With every good wish,  
Sincerely yours,

JUSTIN BLACKWELDER.

THE NEW HAVEN FOUNDATION,  
New Haven, Conn., November 8, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations, Indiana State Office, 447 Federal  
Building, Indianapolis, Ind.

DEAR SENATOR: Thank you for your letter of October 11th, and the two reprints from the Congressional Record which you were kind enough to send me. I read them with much interest. The review of the background to the four per cent excise tax, and the minimum distribution requirements, were interesting and instructive. I of course had general knowledge of the two subjects, but not all the details.

What interested—and intrigued—me most were the five questions you posed in setting forth the direction of inquiry proposed over the next two years, following the summary under Series No. 2. We ask ourselves those same questions constantly, particularly the last two. Nothing could be healthier for the whole foundation field than to have these questions constantly kept in the forefront of our thinking.

There are obviously no categorical answers, nor do I think there should be. The questions themselves point to the underlying philosophical basis for having foundations at all (i.e. diversity, and strengthening the non-governmental sector of society), and to some extent go to the heart of the question of the tradeoff between spontaneity and regimentation. If all foundations operated according to some all-wise code of purpose and procedure, it would be easier to judge their works: they would either conform or not conform. On the other hand, creativity and searching out new ideas and approaches are not neat and orderly activities. There are pitfalls and failures and errors. The main concern should be that foundations have the chance to dare to take risks; also the right to differ and be different—and even espouse unpopular causes.

I'm glad that you feel there is justification for foundations—both private and public—and that you and your committee are striving to develop the most constructive kind of public policy to make this part of the private sector vigorous.

While I have this occasion to be responding to your remarks about the foundation field, I hope it isn't presumptuous of me to ask you whether the whole field of fund-raising comes under the scope of your inquiry. If there are short-comings in our field, I suspect they are minor in comparison to the abuses found in the field of fund-raising. I refer specifically to fund-raising through mail solicitation. Doubtless you are familiar with these abuses—they are well documented in a recent book by the title of "GIVE". It seems to me that if it was important to have "truth-in-lending" legislation, it is equally important to have a "truth in soliciting" bill which would require at least an audited financial report of any organization using the United States mails to solicit funds. I would be interested in our views on that subject, and whether anything is being done by Congress in that area.

Sincerely yours,

NORMAN HARBOWER, Jr.,  
Director.

THE HENRY FRANCIS DU PONT WINTERTHUR MUSEUM,  
Winterthur, Del., October 24, 1974.

Hon. JOSEPH R. BIDEN, Jr.,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR BIDEN: Thank you for your letter of October 11, 1974, requesting in behalf of Senator Hartke, our views on the existing tax legislation affecting Winterthur, and other museums and research libraries throughout the country.

First let me explain that an IRS ruling on May 3, 1974 (a copy of which is attached), tentatively established Winterthur as a publicly supported organization, and not as a private operating foundation, for a 60-month period starting January 1, 1974.

I say "tentatively" because the formal procedure we have undertaken in attempting to terminate our private foundation status is known as the "60-month termination procedure" and at the conclusion of that period, December 31, 1978, we must appear before IRS and prove that we did indeed meet the basic test of a museum 10-percent public support plus other "facts and circumstances."

If we fail to meet the test, we must then pay 4-percent excise tax on investment income for the years 1974, 1975, 1976, 1977, and 1978. At an estimated \$120,000 a year this could amount to \$600,000 plus interest. (For the years 1970-1973 inclusive we paid \$478,903 in tax and interest.) There is little choice but to set aside these funds in each of the current years.

After the year 1978 we must requalify each year in order to stay off the private foundation list.

The tentative nature of this procedure is apparent. Funds desperately needed to maintain services in the face of rising costs must be withheld. Even if we should qualify for the exemption in five years, we will need to meet the requirements each year thereafter. As inflation increases the likelihood of generous public support diminishes.

In short, we continue to feel, along with many other museums and libraries throughout the country who provide important public services at little or no direct cost to government, that we are being penalized simply because the main source of our income has come from private philanthropy rather than tax revenues. We believe that these institutions should be judged on the basis of the quality of services they perform, rather than on the source of their income.

And finally, may I stress again that museums and research libraries are custodians of much of the historic and artistic national treasure of our country. They use these resources for a broad range of public educational services. At Winterthur, for example, we have classes for public schools and carry on at our own expense in cooperation with the University of Delaware, two graduate programs. Yet neither Winterthur, nor any American museum, has been designated by Congress as an educational institution.

Not only do the affected museums and research libraries feel as if they are being penalized by the present tax laws and the failure of Congress to designate them as educational institutions, but inflation is crippling their programs of public service. The most immediate relief Congress could provide would be to exempt us from the 4-percent excise tax.

We recognize that proper safeguards to prevent abuse must be included in any changes in the tax laws. Effective options exist.

Amplification of these and other facts and comments will be found in the testimony I presented before the House Committee on Ways and Means on April 11, 1973.

Please let me know if I can provide further information. And thank you again for your inquiry.

Sincerely,

CHARLES VAN RAVENSWAAY, *Director.*

STATEMENT OF CHARLES VAN RAVENSWAAY, ON BEHALF OF THE ASSOCIATION OF ART MUSEUM DIRECTORS, BEFORE THE COMMITTEE ON WAYS AND MEANS ON THE SUBJECT OF TAX REFORM

My name is Charles van Ravenswaay. I am substituting for Mitchell Wilder, the present President of the Association of Art Museum Directors, who had to meet a previous engagement to the USIA to speak in Vienna, Austria on a date which conflicted with his appearance before this Committee.

While I am the Director of the Henry F. duPont Winterthur Museum, Winterthur, Delaware, an institution which has exhibited its collection of early American materials for over 30 years, these comments are submitted in my capacity as a member of the Association of Art Museum Directors, an organization composed of the directors of approximately 84 of the leading art museums in our country. Although it appears that a majority of the museums represented in the Association qualify as publicly-supported organizations described in Section 170(b)(1)(A)(vi) of the Code (despite the addition of the 10 percent public support test for qualification under the new Treasury Regulations), the Association is concerned about many of its members and non-members which may not qualify. Accordingly, my remarks concern museums as a class, rather than the particular problems of any individual organization.

HISTORY OF MUSEUMS

Historically museums are among the newest forms of American cultural and educational institutions—certainly more recent than schools and colleges which were already in existence, established and accepted in the late 18th century; or libraries which proliferated in the latter half of the 19th century. Most American museums were not founded until the 20th century. Although the great art museum of Boston and The Metropolitan Museum of Art in New York were both founded in 1870, such other significant art museums as those in Cleveland, Los Angeles, Baltimore, Kansas City, Minneapolis, San Francisco, Toledo, the National Gallery of Art in Washington and the majority of other American art museums were founded after 1900. They are therefore relatively new, less understood and consequently less accepted. The significant part they play in the quality of life in our country is not yet recognized so clearly as are those of schools, colleges, libraries, etc.

NATIONAL INTEREST IN MUSEUMS

National recognition of the place of museums in our cultural life has come in recent years from the National Council on the Arts (to which were originally appointed three art museum directors). It has continued to grow with recent statements specifically related to museums' services and needs by The Honorable Nancy Hanks, Chairman of the National Endowment for the Arts, and most recently by President Nixon. Specific proposals to help support museums in order that they may better serve their communities are embodied in The Museum Services Act introduced in the House of Representatives by Representatives John Brademas and Dan Rostenkowski, and in the Senate by Senator Pell.

We have therefore reached a time in our national history when the public services of American museums are not only recognized but avidly sought by the people of our country. (It is estimated that 700,000,000 people visited American museums last year.)

Often, however, public support for museums has lagged behind public services offered; and it is only within the past few years that any federal funding has been made available to augment private philanthropy and local financing.

## HOW AMERICAN MUSEUMS DIFFER FROM FOREIGN MUSEUMS

To understand this phenomenon, one must understand one peculiarly American aspect of the museums of our country which has traditionally set them apart from almost all foreign museums.

Most museums in Europe, for example, are composed of royal or noble private collections which became public property, sometimes by gift but more frequently by appropriation through revolution or war. The tradition of royalty is indeed so strong that many great European museums are still housed in palaces. (The Louvre in Paris and the Hermitage in Leningrad are two examples.) These museums are for the most part considered national property and are completely supported by national funds. They exist for the most part in the capitals of their countries and what museums exist outside these capitals are often considered as provincial appendages of the national museums.

In the United States, however, museums were for the most part founded in various cities by a few civic leaders who provided endowments through gifts and bequests to support these institutions for the benefit of all. Two other significant typical American aspects should be noted:

(1) Almost all founding boards of museums in the United States were composed of individuals representing the interest of the public, not only of representative civic leaders, but also of leading educators; and

(2) Museums sprang up spontaneously in many cities across our land founded and supported entirely by local sources, often by a few individuals.

The idealism represented by these American leaders across our country who sought to establish museums for the people in their region and the strong educational tendency implied by the educators on most of these early boards is in direct contrast to the centralized and closed nature of the great collections in the capital cities of Europe which were opened as museums to the public usually subsequent to political upheaval or revolution.

American art museums therefore serve large segments of their communities, are educational institutions by tradition and practice, play an expanding part in America's cultural growth and development. Recognition of the cultural contributions of art museums has come through legislative support, certain exemptions from taxation for the museums and charitable deductions for donors to the museums. There has been an atmosphere of support and understanding for museums among most legislators and government officials.

## PUBLIC SERVICES OFFERED BY MUSEUMS

The public services offered by American art museums generally follow a common pattern, with variations of emphasis. They have collections of art available to all. They add to these collections by purchase or gift. Research conducted by museum curators results in increased knowledge of the history of art, often published in scholarly books, catalogues and journals. Interpretations of the museums' collections by trained educators enables the public to increase its knowledge and pleasure when viewing the collections. Museum specialists preserve and protect these collections of fragile and often old objects of art, display them in such ways as to enhance public understanding. In addition, most, but not all, museums present temporary art exhibitions on a variety of themes to enhance the public's knowledge; and most museums maintain formal educational programs for adults and children. Most museums offer free admissions, but as costs rise there is a trend toward nominal admission fees. More generally, modest fees are charged for the formal educational programs (but not for the interpretative programs), and for special temporary exhibitions where partial recovery of costs of assembling such exhibitions is necessary.

These varied public services are generally considered to be both educational in nature and to enhance the quality of life in the museum's community. They complement the rapid growth in art museum collections and public interest in art which has greatly accelerated in the past 25 years.

## ART MUSEUM FUNDING

Traditionally, these public services have been funded by endowments and gifts supplemented in varying degrees by public contributions usually in the form of museum memberships, voluntary gifts and grants. As the demand for these public services has grown and their educational significance has become



more recognized, city, county and occasionally state funds have supplemented the traditional financing. Federal funding has so far played a very small role in museum support, except, of course, for the National Gallery of Art and the Smithsonian Institution which are national institutions. Other notable exceptions are the two state-supported art museums in Virginia and Arkansas and the two city-supported art museums, Detroit and St. Louis. Also, some of our leading colleges and universities maintain museums in connection with their departments of art, history and science.

#### TODAY'S NEEDS

Growing public demand for museum services is beginning to be recognized at a time when inflation has made it increasingly difficult for museums to continue to offer these services. Increasing government support for museums has been urged by many officials at many levels and most recently by President Nixon. Much legislation, including that involving taxation, favors support of art museums, and generally the Tax Reform Act of 1969 relating to charitable institutions has set standards under which most art museums may qualify. However, because the tests are based on the museums' sources of support rather than on the public services offered, certain inequities occur.

#### INEQUITIES

While many art museums can qualify as publicly supported under one of the tests applied to institutions under Section 509(a)(1) or (2) of the Code, some because of their comparatively large endowments have difficulty meeting the new standards prescribed in the Treasury's amended Regulations for measuring "substantial" public support." Among these are some of America's most significant art museums such as the Frick Collection, New York City (probably America's finest single collection of art); and the Gardner Museum, Boston (the choicest art collection in New England, home of the greatest Titian in America, a teaching source for all New England colleges for three generations). There are in addition other leading art museums, including my own, which may not be able to qualify under the 10 percent public support requirement, such as the Currier Art Gallery in New Hampshire, a significant small regional center, particularly for American art, and the Clark Art Institute, Williamstown, Massachusetts, which has one of the finest collections of paintings and American silver and which serves Williams College not only as a great resource for original art material, but by regularly providing world-famous art scholars to teach seminars to Williams College students.

In addition to such well-known art museums, it is probable that many museums in our smaller towns and localities will have difficulty satisfying the rigid 10 percent public support requirement of the Treasury Regulations since it is likely that such museums may receive their main support from a few wealthy benefactors.

In most instances the reason such museums cannot meet the "substantial public support" test is that they have been supported by single endowments sufficient in size so that it has not been necessary in the past for the public to support them. This, of course, is in most cases changing with the times. Substantially all of these museums now solicit public funds through memberships, voluntary gifts, grants from public sources; some are close to meeting the "10 percent test," some will need more time to do so because of the size of their basic endowments, and some simply will not be able to meet the 10 percent floor in the foreseeable future.

#### SERVICES THE SAME

However, these institutions all offer substantially the same public services as do those museums which clearly qualify as being publicly supported. They are among the most beneficial and most significant museums in our country. The Frick Collection has traditionally offered free admission, free lectures, free concerts to all and has maintained open hours comparable to most other museums. In addition, it has for many years served as a training center for museum educators and curators. Several art museum directors and many curators began their careers under the famed Frick training program. To penalize with a tax such an institution simply because it has to recent date not been necessary to finance these services with public funds would be comparable to taxation of a

significant graduate school of a university or a hospital engaged in training interns.

Failure of any of these and other art museums to meet the substantial public support provision will only result in reduction of income available to provide their public services. The demand for such services will grow, not diminish, in the years to come; and additional support will have to come from public sources to make up for what is taken away through taxation.

The public welfare is not being served by subjecting such museums to the four percent excise tax applicable to private foundations.

Obviously, remedial legislation is needed. Essentially, the test for museum qualification as public organizations should be based on public services offered rather than on sources of funds which make possible these services. It is, after all, the museums' educational public services which benefit the people of our land in ever-increasing numbers. Their funds, whether from private or public sources, make possible these services. Their funds should in no way be curtailed through taxation at the very moment when public demand for their services is growing and public recognition is being clearly demonstrated.

#### SPECIFIC SUGGESTIONS

##### *1. Relief for art museums subjected to the four percent excise tax on private foundations*

The Association of Art Museum Directors supports the enactment of legislation along the lines of H.R. 704, which was introduced on January 3, 1973, by Representative Koch of New York. That bill would "amend the Internal Revenue Code of 1954 to provide that the 4 percent excise tax on the net investment income of a private foundation shall not apply to a private foundation organized and operated exclusively as a library or museum."

However, in view of the possibly restrictive interpretation which could be placed on the word "exclusively," we would prefer that the word "primarily" or some similar word be substituted. For example, my own museum conducts, with the University of Delaware, a graduate program in Early American culture, and, of course, has a library and botanical gardens, as well as an art collection. We have no objection, however, to the limitation of the proposal to an organization which generally provides the facilities or services indicated directly for the benefit of the public on a continuing basis.

##### *2. Restoration of charitable contribution deduction for donor-artists*

The Association of Art Museum Directors also wishes to go on record as supporting the enactment of legislation which will provide a federal income tax charitable contribution deduction for the fair market value of donor-created works of art that are given to museums or other charitable organizations for a use related to the donee's exempt purpose or function.

##### *3. Opposition to further restrictions on the charitable contribution deduction*

In addition, the Association of Art Museum Directors wishes to express its opposition to any changes in the income, estate and gift tax laws which will reduce incentives for charitable giving. At this critical point in our history, when our Nation's art museums and other cultural institutions are struggling more than ever to survive, and when the significant educational contribution of art museums and other cultural institutions is beginning to be recognized and appreciated at all levels, including the federal government, one thing that we definitely do not need is a rash of more tax law amendments which will adversely affect continued giving of works of art and other appreciated property to museums and other cultural organizations. We desperately need more support from our government, but not at the expense of less support from the private sector.

The enlightened policy our government has followed in providing, since 1917, tax incentives for private giving to the public domain has proved to be a successful stimulant for contributions to our American museums. The tremendous achievements in the growth of the collections of American art museums have been a direct result of this wise policy.

These results are well known and much envied by the state-controlled and state-supported museums of Europe, which do not enjoy comparable private philanthropic support. There is no comparison in the growths of the art museum collections of Europe and those of America in the last fifty years. One of the self-evident reasons for the extraordinary flourishing of American art museums as opposed to the dormancy of growth of European art museums is the beneficial

government support of our museums by the tax treatment afforded gifts and bequests of works of art in particular and appreciated property in general.

There is no denying that the growth of the collections of our museums and historic shrines from the time of the First World War to the present has been the admiration of the world. The majority of works in the museums of Washington, New York, Chicago, Fort Worth, Tulsa, Los Angeles and the vast majority of other such institutions throughout the country are seen by the public because of private giving encouraged in the past by our own government's enlightened tax policies. Let us not abandon them now.

#### 4. *Reduction of tax on private foundations*

Finally, the Association of Art Museum Directors favors legislation to reduce the excise tax on private foundations in general. The only excuse for applying such a penalty tax is that it covers the costs of policing private foundations under the provisions added by the Tax Reform Act of 1969. However, the total amounts being collected from private foundations greatly exceed such costs. Thus, if the tax is to be retained, it should be reduced at least to two percent, since revenues from the tax are exceeding costs of auditing all exempt organizations by that amount. This would have the effect of leaving more foundation funds available for contribution to art museums and other cultural and educational organizations.

DEPARTMENT OF THE TREASURY,  
INTERNAL REVENUE SERVICE,  
Washington, D.C., May 3, 1974.

THE HENRY FRANCIS DU PONT WINTERTHUR MUSEUM, INC.,  
Winterthur, Del.

GENTLEMEN: This is in reply to your request for an advance ruling under the provisions of Regulations section 1.507-2(e) permitting you to terminate your private foundation status.

Our records indicate that you operate a museum of early American culture, Winterthur, which is open to the public. You also conduct many research, educational, and cultural programs for the benefit of the public. You were recognized as exempt from Federal income taxes under section 501(c)(3) of the Internal Revenue Code by letter dated May 19, 1953.

Winterthur was created by Henry Francis du Pont, who was your only substantial contributor until his death in 1969. Your support is derived from an endowment fund, admission fees, and contributions of cash and collection pieces. We have further determined you can reasonably be expected to be an organization of the type described in sections 170(b)(1)(A)(vi) and 509(a)(1). Accordingly, you will be treated as a publicly supported organization and not a private foundation, for an advanced ruling period beginning January 1, 1974.

Regulations section 1.507-2(d) provides that in order to meet the requirement of section 507(b)(1)(B) of the 60 month termination period as a section 509(a)(1) organization, you must meet the requirements of section 509(a)(1) for a continuous period of at least 60 calendar months.

For purposes of section 507(b)(1)(B) of the Code, you will be considered to be a section 509(a)(1) organization described in section 170(b)(1)(A)(vi) for a continuous period of 60 calendar months only if you satisfy the provisions of Regulations section 1.170 A-9(e) based upon aggregate data for such entire period, rather than for any shorter period set forth in section 1.170A-9(e). (In our letter issued June 19, 1973, we ruled that you cannot terminate your private foundation status in a 12-month termination under section 507(b)(1)(B)).

At the end of your 60 month termination, however, you must establish with your key District Director, Philadelphia, Pennsylvania, that for such 60 months you were in fact an organization of the type described in section 170(b)(1)(A)(vi). If you establish this fact, you will be classified as a section 509(a)(1) organization as long as you continue to meet the requirements of section 170(b)(1)(A)(vi).

If you fail to satisfy the requirements of section 509(a)(1) for the continuous 60-month period, but you satisfy the requirements of section 509(a)(1) for any taxable year or years during such 60-month period, you will be treated as a section 509(a)(1) organization for such taxable year or years. Grants or contributions made during such taxable year or years shall be treated as made to an organization described in section 509(a)(1).

In addition, sections 507 through 509 and Chapter 42 shall not apply to such organization for any taxable year within such 60-month period for which it does meet such requirements.

Grantors and donors may rely on the determination that you are not a private foundation for your 60-month period. However, if notice that you will no longer be treated as a section 509(a)(1) organization is published in the Internal Revenue Bulletin, grantors and donors may not rely on this determination after the date of such publication. Also, a grantor or donor may not rely on this determination if he was in part responsible for, or was aware of, the act or failure to act that resulted in your loss of section 509(a)(1) status, or acquired knowledge that the Internal Revenue Service had given notice that you would be removed from classification as a section 509(a)(1) organization.

We are informing your key District Director of this action. Please keep this ruling letter in your permanent records.

Sincerely yours,

MILTON CERNY,  
Chief, Rulings Section 1,  
Exempt Organizations Branch.

UNIVERSITY OF DELAWARE,  
Newark, Del., October 24, 1974.

HON. JOSEPH R. BIDEN,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR BIDEN: Thanks for your letter of October 11 and offer to help me with the Subcommittee on Foundations. As you probably know, Senator Hartke has printed the letter I wrote Michael Stern on pages 251-252 of the Hearings on Private Foundations, May 13-June 3, 1974 (U.S. Government Printing Office, 1974).

My concern is for the museums and botanical gardens (especially Winterthur, Hagley, and Longwood Gardens, and others in this area) which as private operating foundations must pay a 4 percent excise tax on their endowment income. In the case of Winterthur this amounted to \$234,492 in 1972-73 and of Hagley to \$238,527 in 1971-73. I do not have figures for Longwood. These taxes mean that the institutions in question must curtail their programs and services to the public. The private operating foundation classification also harms them in that most private foundations that make grants to such institutions now restrict their grants to museums and botanical gardens classified as public charities.

I understand that Winterthur has now been classified tentatively as a public charity and that Hagley hopes to obtain this status before long. But Kyran McGrath, Director of the American Association of Museums, has made a sensible and easily determined suggestion that all museums (this would include botanical gardens) that are accredited according to the high standards of the American Association of Museums be automatically accorded the status of public charities. The accrediting process sets up strictly professional standards and includes visitation of the museum by a group of museum professionals. At present there are fewer than 300 accredited museums in the country, and I doubt whether there will be more than double that number for several years.

The kinds of abuses that the Tax Reform Act of 1969 was directed against would certainly not occur in these accredited museums.

I appreciate your help in this area.

Sincerely,

EDWARD P. ALEXANDER,  
Director of Museum Studies.

DAVID C. COOK FOUNDATION,  
Elgin, Ill., November 27, 1974.

Subject: Private foundations and exempt organizations.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your October 18 letter inviting comments relevant to matters affecting tax exempt organizations.

As a relatively small "operating" foundation, we have been greatly encouraged by the concerned and swift action that you and the Sub Committee on Foundations propose taking during the 94th Congress.

The subjects listed in the Agenda noted in the Congressional Record on September 26, 1974, are pertinent and extremely relevant.

The David C. Cook Foundation, organized in 1944, is a member of the Council on Foundations. We endorse the efforts that its President, David Freeman and other Council staff, are making to bring about more equitable legislation on the excise tax, distribution requirements and other items of concern to private foundations.

Not only is the present excise tax excessive, but the present tax percentage, the erosion of Foundation portfolios due to declining stock values, and the inflation substantially reduce a foundation's financial outlay for charitable purposes. As you know, there are instances where the very continuance of some foundations is being threatened by these factors.

Thank you Senator Hartke, for your efforts in behalf to tax exempt organizations. We have always endeavored to fulfill our responsibilities to the public and meet the requirements of state and federal governments. It is our hope that during the 94th Congress, some meaningful legislation will be enacted resulting in increased charitable giving by Foundations, due to modified rulings.

Sincerely,

A. C. MONTGOMERY,  
*Director.*

---

CHARLES STEWART MOTT FOUNDATION,  
*Flint, Mich., November 27, 1974.*

HON. VANCE HARTKE,  
*Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.*

DEAR SENATOR HARTKE: Thank you for inviting our response to your statements concerning your meeting agenda, the 4% excise tax, and the minimum distribution requirements which affect private foundations.

With respect to the statement regarding the agenda for the two Series, it is very possible that the ten items listed under Series 2, may be limited in scope. Foundations, it seems conduct grant making activities well beyond those listed. For instance, I might mention education generally, exclusive of higher education itself. Much is done here and much more needs to be done to improve the quality of education from pre-school to the university.

Also, we believe there is great need to grapple with problems of the community. "Urban problems" are important, to be sure. But the problems of community in America are in many ways more urgent. For it is actually "in communities" that we must live, must work, and together must solve our daily demanding problems of alienation, crime, renewal, and education.

Now with respect to the 4% excise tax. We support a reduction in the excise tax from 4% to 2%. It appears this is also your position. We do know, for example that in 1974 those two percentage points would have enabled us to fund an additional Community Education Center (at a cost of approximately \$100,000). We currently fund 15 Centers directly at as many universities in the U.S. The Centers carry on the work of training, dissemination and implementation for the community education movement. An additional Center could bring community education to at least another 100 communities in the U.S. in any given year and train a very large number of people in community education.

Also, we endorse a reduction in the minimum distribution requirement. This we see as desirable particularly where the applicable percentage set by the Treasury Department by necessity should be on a par with the historical average performance of investments in the marketplace according to the creditable indices. It is clear that where the applicable percentage is significantly higher than actual market performance for a given year, a foundation must distribute from its corpus. And this begins to diminish a foundation's capacity to maintain its fund at the highest possible level to obtain the maximum benefits of philanthropy.

Thank you for giving us the opportunity to contribute to your Committee's very important work.

Sincerely,

WILLIAM F. GRIMSHAW,  
*Director of Information.*

BOSTON COLLEGE LAW SCHOOL,  
Brighton, Mass., October 23, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations, Senate Finance Committee, U.S.  
Senate, Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your letter of October 11, enclosing your statements concerning the forthcoming activities of your Subcommittee on Foundations.

The list of topics that your staff has outlined should provide a comprehensive picture of private foundations as they exist today.

I do have one suggestion for an addition to the agenda. I believe that it would be useful for the Committee to examine non-tax alternatives which provide support for charitable organizations, including private foundations. The topic suggested is directly responsive to the question raised in your statement: "How much benefit is the public receiving from the tax exemption accorded private foundations?" In answering this question, I have found it very useful to look at the tax benefits provided by present rules as federal incentive programs and then see if incentive programs outside the tax system can be structured which are more efficient and more effective in their operation. Even if the Subcommittee decided to continue with the present tax rules, the analysis of non-tax alternatives helps sharpen the evaluation of present tax rules as they affect private foundations.

I would be happy to work with a member of your staff if you think this agenda item has merit.

Sincerely,

PAUL R. MCDANIEL,  
Professor of Law.

---

YALE LAW SCHOOL,  
New Haven, Conn., November 7, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: In response to your letter of October 11, 1974, regarding the status of private foundations and other tax-exempt organizations, I am enclosing a copy of my article, Charitable Contributions: Tax Deductions or Matching Grants? This article sets out my views about the propriety, efficiency, and equity of tax allowances for nonprofit organizations. In my opinion, the criticism of these allowances has often been over-severe, obscuring their merits. Moreover, proposed alternatives for these allowances—and especially proposals for cash subsidies by the government—have seldom been examined with sufficient care.

My views on certain aspects of the 1969 legislation are set out in "Should Foundations Be Third-Class Charities," a chapter in "The Future of Foundations," edited by Fritz F. Hellmann. I am sure that a copy of this symposium volume is available to the staff of your Subcommittee.

Sincerely yours,

BORIS I. BITTKER.

---

GEORGETOWN UNIVERSITY,  
DEPARTMENT OF ECONOMICS,  
Washington, D.C., October 31, 1974.

Senator VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: This is in reply to your letter of October 11, 1974 requesting my views on two statements that you put in the Congressional Record on private foundations and other exempt organizations. I do have views on these matters that I will outline briefly here.

From the standpoint of your Committee I think the most basic issue concerns the general posture of the Federal Government and the Congress toward tax exempt organizations. The tone of this relationship has much to do with what you should attempt to accomplish in your subcommittee.

Most economists and many lawyers make the initial assumption that a deduction for contributions and an exemption for investment income on endowments of charities are subsidiaries. This has been developed most clearly in the tax expenditure writing of Prof. Stanley Surrey.

Most people connected with the management of charitable funds bristle at this language, particularly the hated word "subsidy". An alternative to the subsidy-view has been articulated in a scholarly way by Prof. Boris Bittker, that deduction for contributions is a proper deduction under the concept of personal income because it is not income used by the person for his personal enjoyment.

While this appears to be a mere quibble about words, it seems to me to have some operational importance. People who call the tax benefits to charity a subsidy or a tax expenditure also believe, by and large, that the whole business should be subjected to cost-benefit analysis like other government expenditures. (This, of course, is a loose way of speaking. There are many government programs, such as maritime subsidies, which are just rip-offs on the taxpayers and are not subjected to any critical cost-benefit analysis. But, by and large, most government expenditures are subjected to more cost-benefit analysis than, say, the deduction for the cost of business wages under the income tax.)

The people who object to calling the tax benefits to charity a subsidy believe, by and large, that the justification of these benefits lies in the political philosophy of pluralism. The essence of this position is that tax benefits should result in the transfer of some resources to churches, schools, research organizations, etc., and that government should not ask questions about how efficiently the funds are being spent. The essence of the pluralist philosophy is that there should be collective decision centers in the society which are substantially independent of government.

As applied to schools, for example, the subsidy approach, with its emphasis on costs and benefits, comes close to asking if private schools are spending their educational funds in the same way that government would spend educational funds. This is clearly contrary to the pluralist view which emphasizes the importance of having institutions that can try to do education differently, the value of experimentation, etc. In the words of Mao Tse-Tung, "let a thousand gardens grow". (These are not bad words although Mao doesn't act like he believes them.)

All of this is quite philosophical and for that reason sounds rather hopeless. People believe one viewpoint or the other and having expressed a belief they simply don't hear what the other side is saying. Nevertheless, I think some useful points can be made.

1. Within the no-subsidy viewpoint one can still raise some peripheral questions about whether the present provisions are too lax.

(a) When contributions are made not to charity directly but to an organization that holds assets for future disposition of capital and or income to charity we may want to impose special limitations on the fund and its operations. These funds may be used indirectly to help the donor etc. This is the foundation problem.

(b) We may think it goes beyond the normal deduction privilege when gifts are made with various kinds of strings, in the form of appreciated property.

(c) We may think that the deduction should be limited in relation to the estate, or the income, etc.

2. Within the subsidy viewpoint one is more or less forced to ask questions about how effectively the system serves education, research etc. Significantly, your Subcommittee has taken the testimony of the Commissioner of Internal Revenue but not the Secretary of H.E.W. The subsidy viewpoint would raise the question, "How do contributions to educational organizations improve education? Could we get more education for the governments revenue loss?" Your Series No. 2 will apparently get into this.

3. Within the subsidy viewpoint it is significant that government supplements the contribution of rich people more per dollar than it does the contributions of poor people. This gives rise to proposals for substituting and tax credit for the deduction so that everyone's charitable contribution would be equally matched.

4. I find a weakness in the general argument for pluralism which underlies the no-subsidy view. There are other ways that government could maintain pluralist organizations e.g. in the school case by subsidizing tuitions. Maintaining the independence of private schools requires apparently some government revenue which now takes the form of supplements to contribution receipts. We could alterna-

tively disallow a contributions deduction for gifts to higher education and grant instead \$1.00 for each \$2.00 raised by tuition. (I have developed these ideas in a paper done for the Filer Commission.)

My own sympathies are with the subsidy viewpoint. The present letter is not, however, an argument for that viewpoint. It is an effort to clarify the basic differences and to orient some practical issues to basic differences. One must judge that the Filer Commission itself was drawn primarily from representatives of existing charities that are heavily dependent on the present patterns of giving. It could be expected that the Commissions report will be within the no-subsidy viewpoint.

Without attempting to push my own preference for the subsidy viewpoint, I would make two specific suggestions about the program of your Subcommittee.

1. The scope should be enlarged to cover the entire area of charitable contributions, not just foundations. I see the foundation issues as only a specialized problem within the no-subsidy viewpoint.

2. You should be hesitant in taking the Filer Commission Report as definitive if it does come out with a general endorsement of the present structure. These basic questions about the contributions deduction deserve to be examined quite thoroughly.

Sincerely yours,

GERARD M. BRANNON,  
*Chairman, Department of Economics.*

---

AETNA LIFE & CASUALTY,  
*Hartford, Conn., October 28, 1974.*

HON. VANCE HARTKE,  
*Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.*

DEAR SENATOR HARTKE: Thank you for your letter of October 11 in which you enclosed two statements concerning activities of the Senate Subcommittee on Foundations and asking for my comments on these statements.

With respect to the first item, a tentative agenda for the Subcommittee during the next two years, I feel that this agenda encompasses a very thorough and objective analysis and investigation of the subject. We note with interest the reference to the Commission on Private Philanthropy and Public Needs in this material and are glad to learn that the Commission's time schedule for completion of this work by the Spring of 1975 corresponds with the schedule of work which your Subcommittee anticipates. I can assure you that we are working hard to adhere to that schedule in issuing the report to the public and to members of the Congress and that we will also make available to your Subcommittee detailed reports of all the research studies which the Commission is sponsoring. We believe this will provide a great deal of new information which hopefully will complement the thorough investigative work your staff is conducting.

With regard to the second attachment to your letter concerning the Subcommittee's view on the 4% excise tax and minimum distribution requirements affecting private foundations, I very much appreciate receiving the Chairman's views on these matters. It seems to me that this will well serve to emphasize to the members of our Commission the importance of these issues and we will find it valuable to receive your views and those of the other Subcommittee members as our work continues.

We appreciate your interest in the work of the Commission, and as Leonard Silverstein mentioned to you in a recent letter, we welcome the opportunity to meet with you. Mr. Silverstein will be contacting you about this very shortly.

Sincerely,

JOHN H. FILER, *Chairman.*

---

RESEARCH CORP.,  
*New York, N.Y., November 1, 1974.*

HON. VANCE HARTKE,  
*Chairman, Subcommittee on Foundations, Committee on Finance, U.S. Senate,  
Washington, D.C.*

DEAR SENATOR HARTKE: I appreciate the invitation in your letter of October 11 to offer my comments and suggestions on the two statements of the Senate Sub-



committee on Foundations. While there are many aspects of the Tax Reform Act of 1969 which are burdensome, frustrating, and perhaps self-defeating, I would like primarily to concentrate on (1) the four percent excise tax which you and the Secretary of the Treasury believe should be reduced to two percent, and (2) the effect a tax decrease would have in increasing dollar-for-dollar the flow of funds for charitable activities.

The table presented in your October 1 statement shows that in fiscal years 1972 and 1973 (the only years on which complete data are available) revenue from the four percent tax was over \$132 million, and the IRS costs for compliance activities for private foundations were some \$25 million. Using this ratio of more than 4-to-1, I suggest that a reduction of the excise tax to one percent would be more than adequate to cover compliance activities for private foundations.

Another comparison is illuminating. Research Corporation, for its fiscal year 1973, paid \$157,000 as its four percent excise tax on private foundations, presumably to cover costs of auditing and supervising the activities of exempt organizations. The amount we paid our certified public accountants that same year for their audit was \$17,800. This very full and detailed audit by our certified public accountants cost but one-ninth of the amount paid by the foundation to the government for costs of an audit in much less detail, and which occurs but biennially. Thus, even allowing for the nominal costs of supervision in addition to the IRS audit, it seems apparent that the four percent excise tax to cover the cost of auditing and supervision is excessive by manyfold.

Equity would suggest that if other exempt organizations require compliance activities, since foundations are taxed for such purposes, the others should be taxed also for their portion of the costs. Is it equitable that charitable foundations pay for compliance activities for noncharitable groups such as (quoting your statement) "social clubs, trade associations, mutual ditch companies, labor organizations . . .?"

Going to my second point, and assuming for the moment the reduction of the excise tax to one percent, let me describe to you the effect the reduction could have on this foundation and its beneficiaries. Although we do not yet have the final figures (our fiscal year ended on October 31) we now estimate that the present four percent tax will result in a tax bill of some \$180,000 for Research Corporation for this year. If the tax were one percent, rather than four, our bill would be about \$45,000, leaving the \$135,000 difference to be available for our grants programs during 1975.

Here are three examples of what this extra \$135,000 could do to benefit our grantees and the general public good. In our Cottrell Programs (natural sciences), it would pay for 15 grants of \$9,000 each to young investigators on college and university faculties for basic research in chemistry, physics and biology. These are the potential leaders in science for tomorrow, creative men and women in the early years of their careers who cannot obtain grants from federal agencies because they have not yet had the opportunity to establish the track records on which they are judged. If they do not get the funds from Research Corporation or another foundation willing to bet on youngsters, not only will their own careers be damaged, but the nation will be deprived of the contributions they can make during their most creative years.

Alternatively, in our Brown-Hazen Program (medical mycology) the tax saving would pay for three multi-year grants of \$45,000 each to medical schools and universities for research and training programs aimed at generating new basic information on fungal diseases, and teaching physicians and clinical technicians how to identify, diagnose and treat these diseases. Ironically, the federal agencies have reduced their support of medical mycology despite the dangers—the magnitude of which is not fully recognized even by the medical fraternity—that these insidious diseases pose to millions of our citizens.

Or, in our Williams-Waterman Program (human nutrition) the \$135,000 would finance for one year 54 Mothercraft Centers in Latin America through which more than 5,000 severely malnourished children under the age of 6 could be rehabilitated and given the chance to grow into the productive and mentally alert adults these underdeveloped nations need if they are ever to become strong.

There are many similar examples in the Research Corporation grants programs, but the above will give you some measure of the public benefits that could result from the reduction of the excise tax on foundations to one percent.

If you wish, I will be happy to furnish further documentation, or I will make myself available to your Subcommittee if you feel I can be of assistance in your further work.

Sincerely yours,

JAMES S. COLES,  
President.

---

THE COLLEGE OF WOOSTER,  
Wooster, Ohio, October 29, 1974.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations,  
U.S. Senate, Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your letter of October 11, 1974, and for your kind invitation for comments or suggestions concerning your Subcommittee's important work concerning tax exempt organizations. It is an honor to receive your request, and I am pleased to respond briefly now and at some length with some figures in a few more weeks after I complete my report to the Filer Commission.

Let me first compliment you and the Subcommittee for the thoughtful statements placed in the Congressional Record on September 28 and on October 4. The list of topics published in the September statement is very comprehensive, and—like the Filer Commission—it ought to keep your staff busy for quite a while.

One additional dimension occurred to me as I reflected on the various topics mentioned, and it arises to a large extent from my European background: the mix of private and public activity, the diversity in the nature of private foundation activity, and the historic pervasiveness of voluntarism as a social force is a striking manifestation of pluralism at work. Granted, voluntarism exists elsewhere; but it would be most difficult to find another illustration where a nation depends to as large a degree as we do on voluntary financial and non-financial support.

DeTocqueville and others have made this point more eloquently than I can. Let me add my own defense, as follows: the dispersion of political and economic power into many hands rather than their concentration into a few has been and continues to be a worthwhile central value of our American system of government. Often the merit of this philosophy is readily seen when we look at non-governmental activities. I think that we must remember that it is not only private power that can corrupt, but government power as well. And so I see a properly supervised private foundation sector as an important element that can help contribute to the dispersion of economic and political (and bureaucratic) power.

And as you point out in your September statement, at a time when budgets are under pressure all around, we need more rather than fewer sources of money with which to finance our myriad social activities. In other contexts we see it as a virtue not to put all the eggs into one basket; all of a sudden some people seem to tell us that we ought to finance—say, higher education—by getting all of our eggs from one source (government), not counting students.

Your October statement is more complex and I hope that you find of interest some of the data that I can send to you and the Subcommittee later. For the present, a few points appear to be germane.

First, the recommendation to lower the tax to two from four percent appears to be sound. Maybe an alternative could be to leave the four percent tax in, but to lower it for those foundations that distribute the reduction in the form of voluntary support.

Second, as you approach your in-depth study, it might be appropriate to question some of the concepts that are being advanced under the heading of "tax reform" and "tax equity." One of these is the Surrey argument according to which philanthropic giving should be viewed as would any other consumer expenditure. This may at first blush not be related to the foundation issue as much as to the issue of whether gifts ought to be tax deductible. But I think there is a connection.

Rather than consumer expenditures, economists have tended to look at certain expenditures by consumers as *investments*. For instance, your purchase of a house (home is not a consumption item in national income accounting, but an investment expenditure. Similarly, a family's expenditure for education has traditionally

been viewed as investment in human capital. And those of us who have some experience with philanthropy know that donors, particularly those who make large gifts, see their benefactions as investments.

The burden of proof ought to be on those who advocate the consumption dimension. The evidence on the investment side is overwhelming throughout the literature, practice, and even the folklore of language.

And it is normal that one expect some sort of return (or incentive) to undertake the act of investing. The tax break may be a sizeable monetary return (if we overlook the ravages of inflation, as we seem to do whenever very long term capital gains are at issue); but over the long pull, the financial benefit to the donor may be much less than the non-financial returns accruing to him or her as the investment accomplishes desired ends. If we had to produce industrial capital in the manner in which the reformers suggest we go about creating (for instance) higher education capital investments, we would surely be an underdeveloped or a totally socialistic enterprise system.

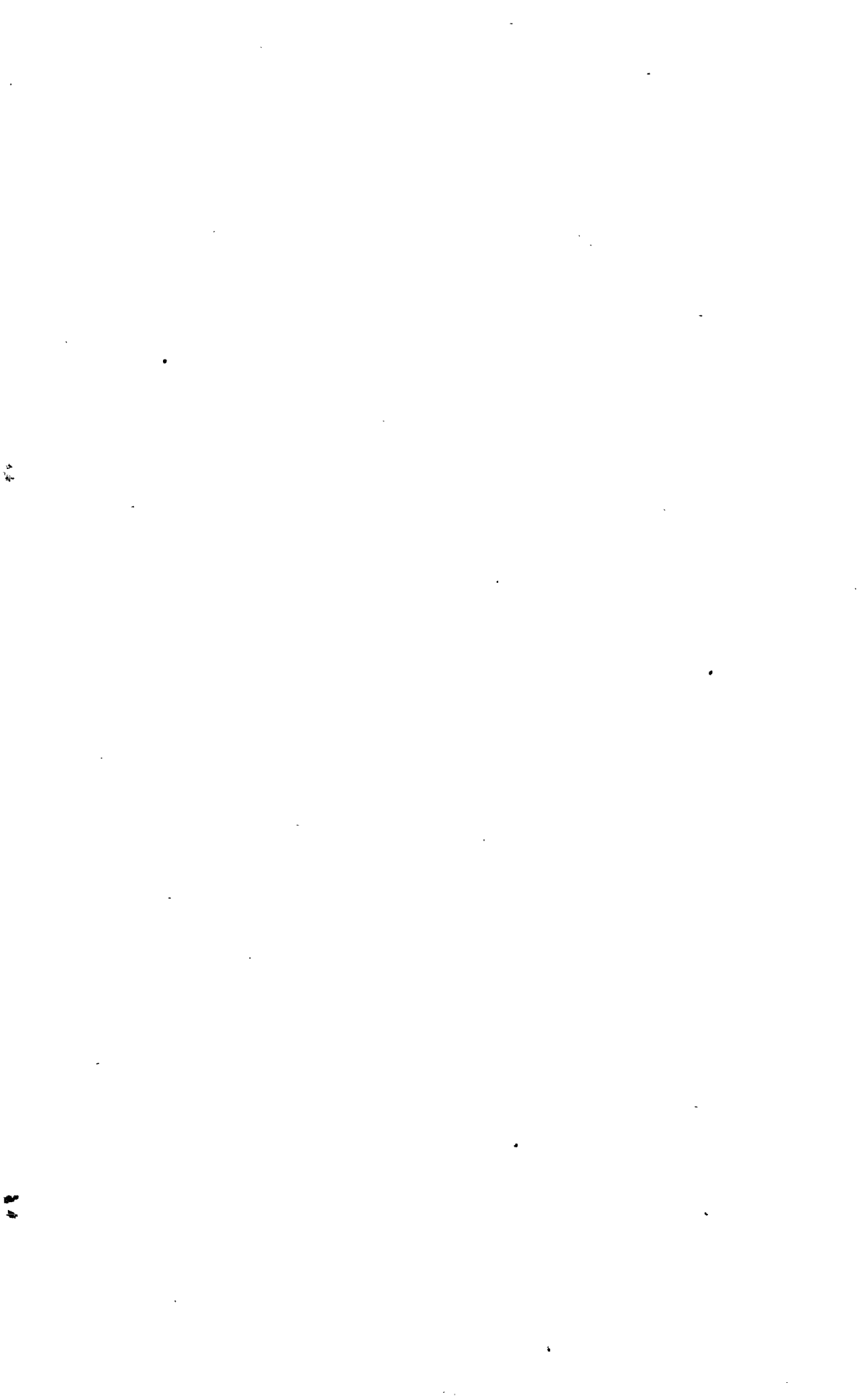
Third, there is the notion that only public spending is in the public interest, a fallacy that is so obvious and perhaps for that reason so pervasive. I agree with your statement that neither the public nor Congress can assess the amount of public benefit derived from the tax exempt status of foundations. Maybe our reasons for this belief differ. I think that it is impossible ever to have a clear idea of where public and private benefits overlap and where they do not, except when explicit definitions are available under which to make the distinction. Some private acts have primarily private benefits as their objective; others are obviously social in their impact. Many public acts are not so much in the public interest as they are in favor of some special private interest, etc. And the rather widespread notion that public officials are better equipped than private organizations in furthering the general welfare flies in the face of the total American experience (and the Russian one, as well, to judge from history).

At any rate, I should hope that forthcoming regulations concerning private foundations and revisions in the tax laws affecting them will not stem from arguments that are based on a philosophy and concept that are questionable in their own right. Instead, I trust, that your Subcommittee may be able to preserve some of the ideals and values that have made this a country where individual citizens still have some choices left on where some of their discretionary dollars will be spent.

I think you again for your kind invitation to address myself to the questions before your Subcommittee, an trusting that I may be of further assistance, I pledge to forward to you some of the data that we are now assembling.

Very respectfully yours,

HANS H. JENNY.



---

---

**Appendix C**

**Material Offered for the Record or Requested by Members of  
the Subcommittee**

---

---



U.S. SENATE,  
COMMITTEE ON GOVERNMENT OPERATIONS,  
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,  
Washington, D.C., March 5, 1969.

HON. DAVID M. KENNEDY,  
*Secretary of the Treasury,*  
Washington, D.C.

DEAR MR. SECRETARY: In accordance with Executive Order 11337, dated March 27, 1967, a resolution was duly adopted by the Committee on Government Operations on September 18, 1968, with regard to the organizations listed on the attached pages. It should be noted that this request was made on December 16, 1968, prior to the expiration of Executive Order 11337. This is to reaffirm the same request pursuant to Executive Order 11454 dated February 7, 1969, and Treasury Decision 6133.

Pursuant to this resolution, I hereby designate the following individuals, members of the Subcommittee staff, to make such examinations: Mr. Phillip R. Manuel, Mr. John E. Drass, Mr. Fred R. Miller, Mr. Perman H. Clay, Mr. James H. Dillon, and Mr. Walter S. Flalkewicz. In this connection, it will be appreciated if the files could be assembled in the district office of jurisdiction. In order to facilitate the work of the staff, it would be further appreciated if the staff designees be permitted to consult with Internal Revenue Agents and Auditors familiar with the content of the respective files.

Your cooperation in this matter will be greatly appreciated.

Sincerely yours,

JOHN L. McCLELLAN, *Chairman.*

1. The Student Non-violent Coordinating Committee, 360 Nelson Street, Atlanta, Georgia.
2. The Student Voice, Inc., 360 Nelson Street, S.W., Atlanta, Georgia.
3. The Sojourner Motor Fleet, Inc., 360 Nelson Street, S.W., Atlanta, Georgia.
4. The Southern Education and Research Institute, Inc., 859½ Hunter Street, Atlanta, Georgia.
5. The Congress of Racial Equality, 200 W. 135th Street, New York, New York.
6. The Students for a Democratic Society, 1608 W. Madison Street, Chicago, Illinois.
7. The Black Panther Party, Oakland, California.
8. The Revolutionary Action Movement, Philadelphia, Pennsylvania.
9. The Deacons for Defense and Justice, Jonesboro, Louisiana.
10. The Nation of Islam, 634 E. 79th Street, Chicago, Illinois.
11. The Afro-American Research Institute, Inc., 224 E. 46th Street, New York, New York.
12. The Southern Conference Education Fund, 3210 West Broadway, Louisville, Kentucky.
13. The Progressive Labor Party, CPO Box 808, Brooklyn, New York.
14. Rosen Publishing Company, 336 Lenox Avenue, New York, New York.
15. Tri-Line Offset Company, Inc., 461 West Broadway, New York, New York.
16. The Medical Committee for Human Rights, New York, New York, with branch offices in Chicago, Illinois; Cambridge, Massachusetts; and Selma, Alabama.
17. The Fund for Education and Legal Defense, 30 E. 42nd Street, New York, New York.
18. The Minutemen, Narbonne, Missouri.
19. The American Nazi Party, Arlington, Virginia.
20. The United Klans of America, Inc., Tuscaloosa, Alabama.
21. The White Knights of the KKK, Laurel, Mississippi.
22. The National States Rights Party, Savannah, Georgia.

## ATTACHMENT A

MARCH 25, 1968.

To: All Regional Commissioners.

From: Assistant Commissioner (Compliance) CP:C:D.

Subject: Student Non-Violent Coordinating Committee and Other Organizations.  
Under Investigation by Senate Committee on Government Operations.

Attached is a list of twenty-two organizations named by the Senate Committee on Government Operations as subjects to be investigated by that Committee. A preliminary inquiry was started during 1968 but was not completed. Other Congressional Committees have also shown an interest in these organizations, and National Office officials may be called upon to testify or produce information concerning them. Some are not much more than a name; others have applications for exemption pending; a few have apparently not filed required tax returns. Most are newsworthy and many are controversial.

Accordingly, this is to request that you prepare a complete, detailed, and comprehensive memorandum for each organization in your region in a format similar to the attachment. When completed they should be sent to the National Office, Attention: CP:C:D.

We have no deadline for receiving this information, but we would appreciate having it before April 30, 1969.

Attachment.

D. L. BACON.

1. *Name and address of organization.*—Show any recent changes in name or address.

2. *Type of organization.*—Furnish date and place of incorporation; if not incorporated, furnish date, place, and type of organization.

3. *Tax return filing and payment history.*—Furnish income tax return filing and payment history for the past three years in all cases, and for a longer period if records of non-filing or non-payment exist. If employment tax returns were required, similar information should be furnished concerning those returns.

4. *Names and addresses of organizers and of present officers.*—Furnish other data which may be useful, such as occupations of the individuals.

5. *Exempt status.*—Furnish date the application was filed, date of approval or rejection, and present status of any pending application.

6. *Information returns.*—If the organization is exempt, furnish information as to whether required returns (Form 990-A or others) have been filed and, if not filed, what action has been taken to secure such returns.

7. *Financial status and source of funds.*—Furnish data concerning the present financial status of the organization and, if known the principal sources of funds including the names and addresses of persons or organizations providing such funds.

8. *Investigative history.*—Furnish information on audit, intelligence, collection, or alcohol, tobacco and firearms investigations of the organizations.

9. *Narrative statement.*—The above items cover some of the basic data needed. We also want information which will give us an overall picture of the organization, its motives, its activities, its attitude, its size, and its impact on the general public.

1. The Student Non-Violent Coordinating Committee, 360 Nelson Street, Atlanta, Georgia.

2. The Student Voice, Inc., 360 Nelson Street, S.W., Atlanta, Georgia.

3. The Soujourner Motor Fleet, Inc., 360 Nelson Street, S.W., Atlanta, Georgia.

4. The Southern Education and Research Institute, Inc. 859½ Hunter Street, Atlanta, Georgia.

5. The Congress of Racial Equality, 200 W. 135th Street, New York, New York.

6. The Students for a Democratic Society, 1608 W. Madison Street, Chicago, Illinois.

7. Black Panther Party, Oakland, California.

8. The Revolutionary Action Movement, Philadelphia, Pennsylvania.

9. The Deacons for Defense and Justice, Jonesboro, Louisiana.

10. The Nation of Islam, 634 E. 79th Street, Chicago, Illinois.

11. The Afro-American Research Institute, Inc., 224 E. 46th Street, New York, New York.



12. The Southern Conference Education Fund, 3210 West Broadway, Louisville, Kentucky.
13. The Progressive Labor Party, CPO Box 808, Brooklyn, New York.
14. Rosen Publishing Company, 336 Lenox Avenue, New York, New York.
15. Tri-Line Offset Company, Inc., 461 West Broadway, New York, New York.
16. The Medical Committee for Human Rights, New York, New York, with branch offices in Chicago, Illinois; Cambridge, Massachusetts; and Selma, Alabama.
17. The Fund for Education and Legal Defense, 30 E. 42nd Street, New York, New York.
18. The Minutemen, Narbonne, Missouri.
19. The American Nazi Party, Arlington, Virginia.
20. The United Klans of America, Inc., Tuscaloosa, Alabama.
21. The White Knights of the KKK, Laurel, Mississippi.
22. The National States Rights Party, Savannah, Georgia.

## ATTACHMENT B

NOVEMBER 13, 1974.

## OPERATING PROCEDURES GUIDE TRANSMITTAL

*Purpose*

This memorandum transmits procedures for handling of "Activist Organizations" cases, and three lists of activist organizations.

*Insertion*

Insert attached pages as Tab 40.

*Pen-and-Ink Changes*

Add to Table of Contents: Procedures for Handling Activist Organization Cases—Tab 40.

*Nature of Changes*

These are procedures for handling cases on "Activist Organizations" and for coordination with Compliance's Activist Organizations Committee. Three lists of activist organizations are included as exhibits.

L. B. JEROME,

*Chief, Exempt Organizations Branch.*

## EXEMPT ORGANIZATIONS BRANCH PROCEDURES FOR HANDLING ACTIVIST ORGANIZATIONS CASES

## 1. BACKGROUND

1. The Assistant Commissioner (Compliance) has established an "Activist Organizations Committee" to coordinate compliance programs dealing with "activist organizations", to "collect basic intelligence data, and to ensure that the requirements of the Internal Revenue Code . . . have been complied with." A number of other Service functions have appointed liaison representatives to this committee. A member of this Branch is one of Technical's liaison representatives.

2. The committee has described the organizations with which it is concerned as "Ideological, militant, subversive, radical, and similar type organizations." The attached lists show a number of specific organizations with which the committee has been concerned. Its interest now extends to all similar organizations.

3. Technical's participation in this effort is to assist Compliance with the most efficient exchange of information possible, and to ensure that no erroneous technical advice or rulings are issued due to lack of information. The following procedures are set out to accomplish this.

## 2. PROCEDURES FOR EXCHANGING INFORMATION ON ACTIVIST ORGANIZATIONS

1. The Activist Organizations Committee will be given an opportunity to see all open case files pertaining to activist organizations. The Branch representative to the Committee will act as coordinator for this purpose.

2. Any case involving one of the listed organizations will be routed to the coordinator, Paul Kane, room 7041, for referral to the Committee. In addition, each group chief in the Rulings Section will select any other cases for referral that involve organizations he considers similar to the listed organizations, or that are described in 1.2, above. The coordinator will forward these cases to the Committee. He may consult with the Chief, Rulings Section, as necessary. All technical employees will refer cases to their group chiefs that appear to involve "activist" organizations. The coordinator will forward these cases to the Committee.

3. The Committee in turn will examine the cases and flag those cases which they consider important to their program. Such cases will be designated "Committee cases." They will also add to the file whatever information they wish us to consider in our disposition of the case. This may be in the form of investigative files, summaries, or other material.

4. On cases they designate as "Committee cases," the Committee will indicate what individuals and organizations, if any, have been checked out through FBI sources. Per section 3.5, all contact with the FBI on Committee cases will be through the Committee.

5. The Committee will handle this initial information exchange on a reasonably prompt basis and will return the cases to the Branch for processing via the coordinator. To the extent the Committee deems it necessary they may forward supplemental information through the same channels.

### 3. PROCESSING OF COMMITTEE CASES

1. Cases which the Committee has flagged will be handled in accordance with the following procedures.

2. The procedures of Rev. Proc. 69-3 will be followed in these cases as in all others. Since these cases are likely to become increasingly sensitive, administrative due process should be observed carefully.

3. Any investigative data or other unpublished data that the Committee may supply for our use will be treated as confidential unless the Committee has, by signed memorandum, specifically authorized disclosure of the information to the taxpayer or others. Where the Committee does so authorize disclosure they will take the responsibility of clearing such action with the investigative agency involved.

4. Where confidential information is not available for disclosure it may not be the basis of our ruling action. It will be used as a source of leads for the development of information on which to base a ruling.

5. Compliance has centralized in the Committee all of its contacts with the FBI and the Senate Committee on Government Operations. To prevent duplication, this Branch will ask the Committee to handle all of our contacts with those sources. This Branch will continue to handle contacts with District offices to develop information from local sources, and contacts with other Federal agencies.

6. Where a Committee case is to be closed by action adverse to the taxpayer, the closing document will, before mailing, be routed through the Branch coordinator who will advise the Committee of the case's disposition.

7. Where it appears that our final action will be a favorable ruling or technical advice, the proposed favorable action will be forwarded to the Conference and Review Staff for review.

8. If the Conference and Review Staff concludes that a favorable action is indicated, the case will be routed to the Committee through the Branch coordinator, before the action is signed. The Committee will be given the opportunity to comment.

9. If the Committee has objections to the issuance of the ruling, their comments will be given full consideration by the Conference and Review staff. If it still appears that favorable action is legally required under the applicable law the case will be submitted to the Chief Counsel for concurrence or comments.

10. If Chief Counsel is of the opinion that a favorable action is appropriate, the case will be forwarded for review to the Office of the Assistant Commissioner (Technical), after notification to the Committee by the Branch coordinator to permit Compliance officials to present their views at the Assistant Commissioner's level.

---

---

**Appendix D —**

---

**Communications With the Internal Revenue Service**

---

---



COMMISSIONER,  
DEPARTMENT OF THE TREASURY,  
INTERNAL REVENUE SERVICE,  
Washington, D.C., November 19, 1974.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations, Senate Finance Committee, Wash-  
ington, D.C.

DEAR MR. CHAIRMAN: This will confirm my appearance before the Subcommittee at 9:30 a.m. on Monday, November 25, 1974. As in my previous appearance, I will be accompanied by the particular members of my staff who have assisted in preparing the material in response to your letter of November 6.

Before commenting on the items in your letter, I want to express my personal gratification at our agency's ability to respond to your requests for data in recent months. I have also appreciated the opportunity to share with Howard Marlowe on an informal basis both our immediate and long range goals and, specifically, ways in which we can assist you and the Subcommittee in performing your study and analyses. The suggestions and recommendations we have received from you have been helpful and constructive, and many of them have been incorporated into our planning for the new Office of Assistant Commissioner for Employee Plans and Exempt Organizations.

The thirteen questions in your November 6 letter call for several different responses. Questions 8 and 9 ask for a policy response which is properly the province of the Department of the Treasury. I forwarded a copy of your letter with attachments to Mr. Frederic W. Hickman, Assistant Secretary for Tax Policy, with the request that his office prepare an appropriate response and communicate it to you. Questions 10 and 11 arrived at the very time when we are developing and presenting the required data to the Office of Management and Budget in support of our budget estimates of resources required to carry out our duties under the Employment Retirement Income Security Act of 1974. Hopefully, I will be able to enlighten the Subcommittee in my testimony on the progress, if not the outcome, of our efforts. A package of material in response to Question 13 is attached. Finally, the answer to the first part of Question 2 is affirmative. The item from which that total was derived is Item 13, Part III of the Form 990 PF. It represents total assets, including those held for charitable purposes and those held solely for investment.

Questions 3, 4, 5, 6, 7, and the second part of Question 2 present special problems which deserve some comment. These requests for statistical data break down into two categories: first, those requesting information found only on exempt organization returns, and second, those requiring an analysis of as many as five or six types of returns in addition to the Form 990 PF. Questions 3, 4, and 5 fall into this latter category; Questions 2, 6, and 7 into the former.

To provide an analysis of even a sample of the appropriate returns in which data requested in Questions 3, 4 and 5 appear would entail a complex procedure which is described in a document I have attached here as Exhibit A. Essentially, we would have to locate and retrieve the Form 990 PF from a statistically valid sample of private foundation returns; extract the names or identity of contributors of the various kinds of property in which you are interested; and, in the universe of individual, estate, gift, fiduciary and corporate returns, locate the return of those particular individuals or entities from which we would learn the nature and value of the property donated. I would be less than candid if I did not confess some strong reservations about the wisdom of allocating the enormous resources which would be required to accomplish this.

We have, however, virtually completed a study of reporting characteristics of some 7,000 private foundation returns. We know a considerable amount about those particular returns which were scientifically selected for this study. My staff is presently preparing for me a detailed analysis of the problems we would face in attempting to answer Questions 3, 4, and 5, and I would sincerely hope

that your staff would feel free to participate with us in attempting to design a study which would meet the needs of the Subcommittee for this information. It is my understanding that members of my staff have already spoken to Howard Marlowe and invited his participation in solving this problem.

The other category of questions does not present the same difficulties as Questions 3, 4, and 5. Our Statistics Division has developed a scientific sample to permit us to respond to Question 7. We are writing a computer program at this time to identify and private a listing of the specific cases to be reviewed, which list will be forwarded to the key district where each file is located along with a standardized form to collect the desired data on termination. We would again invite the participation of your staff in making suggestions about the form on which we will collect our data to insure that it will yield the kind of information you need.

Question 6 and the second part of Question 2 present a slightly different problem. The data referred to is found on Line 5 of Part IX of the Form 990 PF. That item has not been keypunched into the EOMF in previous years. However, the EOMF is undergoing a major redesign and reformat at the present time. Given budget resources, we plan to transcribe that item, along with many others, off of the 1974 Form 990 PF. Our computer specialists inform me that we can expect to begin putting data from the 1974 forms into the redesigned EOMF commencing July 1, 1975, and can expect to have access to it within a few months after that. In an attempt to provide a response at this time, however, we propose to sample the private foundation universe on a scientific basis as you requested and provide that data to the Subcommittee as soon as possible. Although the staff had not completed its analysis of the requirements for this particular study, I expect to respond in some detail at the hearing.

Question Number 1 presents its own kind of difficulty. While one is tempted to speculate about the more obvious causes of the drastic erosion of foundation assets, we are trying to prepare a thoughtful, and we hope, helpful response to a complex and difficult question. I anticipate being able to present that response in my testimony.

In response to Question 12, we have determined from Mr. Marlowe that your reference there was to our annual Technical-Compliance Field Conferences which are held in the regions each year. Two of those conferences have been held since the commencement of this fiscal year and the balance, while scheduled, have been postponed for two reasons: First, on December 2 the new Office of Assistant Commissioner for Employee Plans and Exempt Organizations will officially come into existence with a totally revised and modified organization. The remaining conferences have been postponed until the required organizational changes have been accomplished and a dual purpose can be accomplished by a meeting. The second reason for the postponement is, in one respect, a corollary of the first. All agencies of government, including this one, have been required to reduce expenditures. If we can accomplish reorganization tasks at the same time we carry out the important review of field activities, we will have effected a considerable saving since these field conferences involve substantial time and costs. These are important conferences and they obviously will be continued as a valuable part of our compliance program.

If there is additional information which you require, or additional questions to which you would like us to respond, I would appreciate the earliest possible notice.

With kind regard.

Sincerely,

DONALD C. ALEXANDER.

### Exhibit A

#### FUNCTIONS INVOLVED IN OBTAINING DATA REQUIRED IN ITEMS 3, 4, AND 5

1. Obtain a list of Employer Identification Numbers (EINs) for all or a subsample of the 7,000 Forms 990-PF designated for the sample used in the "1973 Characteristics Study of Private Foundations."
2. Match the list of EINs against the Exempt Organization Master File (EOMF) to obtain the Document Locator Numbers (DLNs) for these returns for 1969 through 1972. (Presumably returns for 1973 would be available from the "Characteristics Study;" and, DLNs for returns prior to tax year 1969 are probably no longer on the EOMF.)

3. Generate return charge-out sheets to be used in selecting returns at the Philadelphia Service Center and its related Federal Records Center.

4. For those returns designated and located, edit the data reported on the foundation's schedule used to support contributions (line 1, Part I, page 1 of Form 990-PF). Perhaps as many as one-half of the returns will have no schedule attached (because there are no substantial contributors). The separation of gifts which is required would have to be made from the names of the contributors. If identifiable, contributors would be classified as individuals or fiduciaries, estates, corporations or partnerships, and tax-exempt organizations. It would then be possible to obtain measures of the information Senator Hartke requires. For example, inter vivos gifts would be all contributors except estates; and, gifts for which income tax deductions were claimed would be individuals, fiduciaries, corporations, and partnerships.

5. Transcribe edited data and convert to tape.

6. Produce summary tabulations.

*Question 13.* Describe the plans which have been developed for the organization and operation of the new Assistant Commissioner's office.

*Answer.* The new organization in the National Office will consist of an Assistant Commissioner (Employee Plans and Exempt Organizations), a Deputy Assistant Commissioner, advisory and support staff consisting of technical advisors in both EP and EO, special assistants to the Assistant Commissioner in both EP and EO, and a staff assistant; and three Divisions: the Employee Plans Division, with Technical and Operations Branches; the Exempt Organizations Division, with Technical and Operations Branches; and the Actuarial Division, with Pension Actuarial and General Actuarial Branches.

The most significant operational and technical changes in the National Office will come as the result of combining compliance functions and EOMF supervision with the staff responsible for technical matters. Those employees now located in the Exempt Organizations Branch of both the Miscellaneous and Special Provisions Tax Division of the Assistant Commissioner (Technical) and the EO Examinations Branch of the Audit Division of the Assistant Commissioner (Compliance) will transfer into the Technical and Operations Branches respectively, of the Exempt Organizations Division. Similar transfers will take place in the EP area.

Although the complete EP/EO organization in the field has not yet been finally set, there will be an Assistant Regional Commissioner (Employee Plans and Exempt Organizations) in each of the seven regions whose staff will include an Executive Assistant to the ARC, plus several Regional Analysts, some of whom will also function as EP and EO conferees.

The EP/EO function will be organized along the key district concept, with the EP/EO function operating out of 19 key districts. EP/EO employees located both in key districts and associate districts will be transferred from the Audit Division to the new EP/EO operation, and will be on the rolls of and receive both functional and line supervision from the key district.

Each key district will have a Chief, Employee Plans and Exempt Organizations Division. Depending upon the size of the staff, there may also be an Operations Branch Chief reporting to the Division Chief. At district option, separate EP or EO examination groups may be established, or examination groups may be integrated with both EP and EO specialists. Where size warrants, separate branches may be established for EO and EP.

In addition to a Service Branch in each key district to handle clerical and control duties, there will also be a Technical Staff composed of EP and EO reviewers. In most key districts this staff will be small.

The new organization will come into official existence December 1. Most personnel actions will be made effective December 8, the beginning of the next pay period.

In general, the responsibilities of the Exempt Organizations Division of the new organization will include all of those matters set forth in the various technical publications which we provided to you over the past few months. Specifically, all of the technical and compliance functions presently performed in the Exempt Organizations Branch (Technical) and the Exempt Organizations Examinations Branch (Compliance), as set forth in the Exempt Organizations manual and handbooks, will be continued. We have previously outlined for the Committee the current fiscal year's audit plan, including the major commitment to the first Taxpayer Compliance Measurement Program in the Exempt Organizations area. This

plan includes also our intention, after completing the private foundation commitment on December 31, 1974, to reorder the audit priorities as I suggested in my letter of October 2 to institutionalize our regulation of private foundations and place more emphasis on the public charity area.

A major change in the Exempt Organizations Division will be the assumption of primary responsibility for conducting delinquency investigations, a function previously performed by the Collections Division of the Office of Assistant Commissioner (Accounts, Collections and Taxpayer Service). That function will become a third major responsibility of the field, in addition to issuing determination letters and performing examinations.

The new Office of Assistant Commissioner (EP/EO) will receive support services from other parts of the IRS. These will include the entire range of data processing services provided by the Assistant Commissioner (ACTS). For example, the major redesign and reformat underway on the EOFM is being performed by personnel in the Accounts and Data Processing Division of the Assistant Commissioner (ACTS).

DECEMBER 4, 1974.

Hon. DONALD C. ALEXANDER,  
*Commissioner, Internal Revenue Service,  
Washington, D.C.*

DEAR COMMISSIONER ALEXANDER: Thank you for appearing before the Senate Subcommittee on Foundations. Your comments were most helpful and informative, and I am pleased to see the work which you are doing to improve the Service's administration of exempt organizations.

Because there was not time for me to ask you all the questions which I had wanted, and because your testimony raised some additional questions, I have prepared the following list of supplemental questions which I hope you will be able to answer at your earliest possible convenience so that they may be included in the printed hearing record.

The first series of questions relates to the Special Service Staff.

1. Have any memoranda of the meeting on May 30, 1973, been provided to the relevant congressional committees studying the Special Service Staff? If so, could you specify which memoranda have been made available? If not, do any such memoranda exist?

2. Have copies of the documents carrying out the termination of the SSS, which documents were signed on August 18, 1973, been furnished to the relevant congressional committees studying that organization? If so, could you specify which documents have been made available? If not, do such documents exist?

3. Would you supply for the record the basis of the Service's legal authority to embark upon and to continue the activities of the Special Service Staff and its predecessor organizations?

4. When did Mr. Green first propose to his superiors that an activist organization staff be formed? If there is any written record of this proposal, has it been furnished to the relevant congressional committees studying the SSS? If it has not been so furnished, does such a written record exist?

5. In your testimony before the Subcommittee on Foundations, you indicated that the category "non-violent groups" was intended to refer to non-violent extremist groups. Is that a correct interpretation of your remarks?

6. What was the source (or sources) of the second list of 55 organizations and the third list of 22 organizations? If there is a written communication providing either or both of these lists from such source (sources), please supply a copy to the Subcommittee.

7. At what date did the Internal Revenue Service first receive contact from anyone at the White House on the need to give special attention to activist or ideological organizations?

8. During the existence of the Special Service Staff and its predecessor organizations, who within the Internal Revenue Service was aware of White House interest in the group?

9. You appear to indicate (on page 66 of the transcript of the Subcommittee's November 25 hearing) that, as of August 9, 1973, you did not have a full understanding of the nature of the work of the Special Service Staff. Is this a correct interpretation of your remarks? If so, what was it about the SSS which you did not fully understand as of the date and why did you not have this understanding?



10. On page 69 of the transcript of the Subcommittee's November 25 hearing, Mr. Willsey states: "At that time, and I have been informed as recently as yesterday, no dissemination whatsoever of the file material themselves was made outside of the Special Service Staff. Those files were maintained in complete integrity within the Special Service Staff file room. . . ." At the same time, IRS documents state that there was a "Select In" and a "Select Out" process used to determine which SSS cases might require further action and which could be closed. Was any of the information from SSS files provided to other personnel within the Service during the termination period of the SSS? Is any of the information generated by the SSS presently being used as part of any on-going taxpayer compliance program of the Internal Revenue Service?

11. Does the taxpayer compliance measurement program which you discussed in your November 25 testimony have any relationship to the type of work which was carried out by the SSS?

12. Can you provide the Subcommittee with any further information about the taxpayer compliance measurement program which you plan to implement?

13. Who within the Internal Revenue Service had responsibility for supervision of the work of the SSS? Were the individual members of the SSS staff responsible to division chiefs or to the head of the SSS? Are there any written materials describing or delineating this chain of command?

14. Was the Commissioner of Internal Revenue kept informed of the activities of the SSS? Are there documents available describing the contact between the SSS and the Commissioner?

15. Is there any record available of contact between the General Counsel's office and the Special Service Staff?

16. In material submitted after your June appearance before this Subcommittee, you stated that some of the sources of information about individuals and organizations included in the review of the Special Service Staff were: (a) The F.B.I., (b) the House Committee on Internal Security, (c) the Senate Subcommittee on Investigations of the Committee on Government Operations, and (d) The Senate Subcommittee to Investigate the Administration of the Internal Security Laws of the Judiciary Committee. After blocking out the names of individual taxpayers and entities, would you supply the Subcommittee with copies of any and all correspondence with these sources which relate to the activities of the Special Service Staff and its predecessor organizations?

17. When an organization was placed on a list to be given special attention by the Special Service Staff, what happened? For instance—

(a) Were its tax returns automatically audited?

(b) Were any requests for rulings from I.R.S. initiated by that organization given special attention?

(c) Was the exempt status or the application for exempt status by any one of the groups on these lists affected in any way by its presence on the list?

(d) Did individuals connected with any of the organizations on these lists receive special attention from I.R.S.?

(e) Of the individuals and organizations which came within the information-gathering functions of the Special Service Staff, how many cases were turned over for collection of taxes, how many were referred for re-evaluation of tax-exempt status, how many were denied tax-exempt status, and how many were turned over to the Department of Justice for criminal investigation or prosecution?

(f) A July 24, 1969, internal I.R.S. file memorandum states that one of the purposes of this group was to determine the extent of the sources of funds to support activist organizations. To what extent was such information disclosed to other government agencies?

18. Did any White House personnel, whether or not they identified themselves as such, request or receive information prepared or collected by the Special Service Staff?

19. This past June, you testified before this Subcommittee to the effect that the SSS was no longer in existence and that its activities had been transferred to other areas of the Service.

(a) During each of the calendar years of its existence, how many individuals were devoted to the work of the Special Service Staff and its predecessor organizations? (If it is helpful, reference can be made to man-hours or man-years.)

(b) How many of these people are still working for the Service?

(c) How many of them are working in activities within the Service related to exempt organizations?

(d) Were any dismissed from the Service or removed from their positions or transferred to other positions or disciplined in any manner because of their involvement in the activities of the Special Service Staff?

(e) What actions have you taken to assure the non-reoccurrence of an activity such as that carried on by this group?

(f) Why has it taken so long for all the facts to become public about this group?

20. When you appeared before this Subcommittee, you stated that the files of the Special Service Staff were kept intact so they could be inspected by the Joint Committee on Internal Revenue Taxation.

(a) Who on the Joint Committee or on the staff of that Committee is authorized to inspect those files?

(b) How many times and on what dates did any of these people inspect the files of the Special Service Staff?

(c) Who else within Congress is authorized to inspect those files?

(d) How many times, and on what dates did any of those people inspect the files of the Special Service Staff?

21. In the I.R.S. press release of August 9, 1973, announcing the abolition of the Special Service Staff, you are quoted as saying: "The tasks now being performed by the (Special Service) Staff can be handled efficiently by other components of the Service as a part of their regular enforcement activities." On August 15, 1973, I.R.S. memorandum of understanding states that a task force would be created to "phase-in" SSS files into regular I.R.S. activities.

(a) Has this task force completed its work?

(b) Are not we left with the impression that the SSS was abolished in name only, but its functions have merely been dispersed within I.R.S.? Is the Service still in the business of giving special attention to groups or individuals who might be termed "activist" or "ideological"?

The second series of questions pertains to other matters.

22. When you appeared before the Subcommittee in June, I asked if you could supply us with a breakdown of the various types of Section 501(c)(3) organizations, especially the various types of public charities. Have you made any progress in accumulating that information?

23. Have you made any progress in tracing the relationships between various types of public charity organizations, such as the relationships between 509 (a) (3), (a) (1), and (a) (2) organizations?

24. Do you feel that you have been hampered in your ability to carry out your exempt organization responsibilities by any fiscal restraints imposed by the Office of Management and Budget?

Thank you for your cooperation in the work of the Subcommittee.

With my best wishes, I am

Sincerely,

VANCE HARTKE,  
Chairman, Subcommittee on Foundations.

COMMISSIONER,  
DEPARTMENT OF THE TREASURY,  
INTERNAL REVENUE SERVICE,  
Washington, D.C., January 18, 1975.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Foundations, Senate Finance Committee, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In reply to your letter of December 4, 1974, we are in the process of preparing responses to the lengthy series of questions relating to the Special Service Staff. Those will be forwarded to you as soon as they are complete. As you may know, the Staff of the Joint Committee on Internal Revenue Taxation is conducting an intensive review of the activities of the Special Service Staff. I have instructed the members of my staff to cooperate with that Committee to the fullest possible extent.

In this letter I will, first, respond to your questions which do not deal with the Special Service Staff and, second, provide you with corrected figures on the total assets of the private foundation community.

**Question 11.** Does the Taxpayer Compliance Measurement Program which you discussed in your November 25 testimony have any relationship to the type of work carried out by the SSS?

Answer. None whatsoever.

**Question 12.** Can you provide the Subcommittee with any further information about the Taxpayer Compliance Measurement Program which you plan to implement?

Answer. I am enclosing Manual Supplement 48G-222, dated September 18, 1974, which was issued to the field as the definitive guide for implementation of the "Taxpayer Compliance Measurement Program—Exempt Organizations." Because this supplement is exhaustive in its description of the program, it should provide a complete response to both questions 11 and 12. However, should you have any further questions, please do not hesitate to direct them to us.

**Question 22.** When you appeared before the Subcommittee in June, I asked if you could supply us with a breakdown of the various types of Section 501 (c) (3) organizations, especially the various types of public charities. Have you made any progress in accumulating that information?

[See response to Question 23.]

**Question 23.** Have you made any progress in tracing the relationships between various types of public charity organizations, such as the relationships between 509(a) (3), (a) (1), and (a) (2) organizations?

Answer. In accordance with the commitment I made to you in June that we would attempt to construct responses to your questions about public charities, we did search the Exempt Organization Master File for the precise breakdowns you requested under the broad public charity category. The results of that computer search simply confirm what we communicated to you in our response to your March 22 questions. A brief review of that response will illustrate the problem.

As of June 30, 1974, we had classified 181,684 organizations as "public charities," including subordinate organizations holding exemption under a group ruling. During the most recent complete reporting year, approximately 80,000 of those organizations filed returns. The difference of some 100,000 represents (1) organizations not required to file Form 990 because their gross receipts were under \$5,000; (2) those public charities claiming exception from the filing requirement as religious organizations; (3) those organizations covered under a group return filed by a central or parent organization; and (4) those organizations which for one reason or another did not file a return even though required to. Any attempt, therefore, to obtain a precise analysis of all public charities based on returns filed with the Service will necessarily be incomplete and unreliable because of the statutory exemptions from filing and the group return provisions.

Our further attempt to analyze the relationships between the various types of public charities is also inconclusive. Schedule A, Part V to the Form 990 is designed to ascertain from the filing organization the reason for non-private foundation status. Although we did an analysis of past responses to that self-classification item, we are not satisfied that the results are sufficiently comprehensive or reliable to use as the basis for any conclusions.

In an effort to respond to the Subcommittee's need for this data, the EOMF Task Force has recommended, and we have implemented in the 1974 Form 990, Schedule A, a substantially revised form to acquire this important data. I have enclosed a copy of the 1974 Form 990 package and refer you specifically to page 2, Part V of Schedule A to Form 990 where we have attempted to simplify and clarify the form in defining the relationships between 509(a) (3) organizations and the supported public charity. For comparative purposes, we are enclosing the 1973 Schedule A to Form 990.

**Question 24.** Do you feel that you have been hampered in your ability to carry out your exempt organizations responsibilities by any fiscal restraints imposed by the Office of Management and Budget?

A brief background is necessary before attempting to answer this question. The budget under which the Exempt Organization Division is operating presently was prepared more than a year ago and approved by the Congress last summer before enactment of the Employee Retirement Income Security Act (ERISA). The merger of the new responsibilities contemplated by that Act with our continuing exempt organization assignments puts the Division in a new budget posture for this and future years.

In our planning for the new Assistant Commissioner's Office, we developed priorities for carrying out what we understand the Congress to expect of the Service under the organization, principal among these being to expand our ability to gather and analyze data about exempt organizations, increase audit coverage, and intensify our efforts to assure uniformity in rulings. It now appears that the supplemental appropriation to establish the new Office and begin implementing the other provisions of ERISA will be substantially less than we requested, and our programs will be correspondingly reduced.

In my testimony on November 25, I pointed out that we had discovered a significant error in our computation of the total of private foundation assets in the October 1974 run of the EOMF. I also informed the Subcommittee that we expected to have a revised figure within a few weeks.

We have conducted our review of the accuracy of the private foundation data on the master file in two stages: first, in order to respond to the Subcommittee expeditiously, we verified the accuracy of the entries of the largest private foundations and others where a high potential for error was indicated. In addition, we applied a number of computer tests to the file through samples to permit us to construct some indices of reliability for this immediate tabulation. We have completed that initial phase and have made adjustments to the master file resulting in a net increase of \$8.1 billion, making the new adjusted total \$25.4 billion for the October 1974 extract rather than \$17.3 billion. I am informed that the method used in computing the \$25.4 billion figure indicates that there is a possibility of a 1.9% error rate or \$400 million  $\pm$ .

Virtually all of the erroneous entries occurred as a result of major processing changes implemented in July 1974. However, one major error was present in the February 1974 total which we previously reported to you at approximately \$26 billion. That figure should be revised to \$29.3 billion. For comparative purposes, therefore, the decline in assets between 1972 and 1973 reporting years approximates \$3.9 billion or 13%.

Second, because of the importance of the private foundation data, I have directed that a manual verification be made of each of the some 29,000 private foundation entries on the master file. Every return will be examined and the accurate transcription of data to the master file verified. While we are examining the returns, we will take the opportunity to verify the accuracy of all other fields of data before any additional summaries are extracted from the file.

As a corollary to the purification of the private foundation file, we will postpone until the completion of Phase 2 providing you with the extract of all private foundations by asset code range and district. The errors which resulted in the incorrect total asset figure are found also in the distribution of foundations throughout various asset code ranges. We will do that extract and others immediately upon the completion of the purification of the master file and forward them to you.

With kind regards,

Sincerely,

DONALD C. ALEXANDER,  
*Commissioner.*