

**Comments of Will Miller, President, The Wallace Foundation
To the Business Income Tax Working Group
Senate Finance Committee
April 15, 2015**

Thank you for the opportunity to share our recommendations for bipartisan tax reform with the Business Income Tax Working Group of the Senate Finance Committee.

I write to you as President of The Wallace Foundation, based in New York City. We are a private independent charitable foundation with approximately \$1.5 billion in assets. We aim to improve learning and enrichment for disadvantaged children and to help foster the vitality of the arts.

I write to ask you to support the inclusion of foundation excise tax simplification, at the revenue neutral flat rate, in the recommendations that are being developed by the Senate Finance Committee Business Income Tax Working Group.

As you may know, each year private foundations are required to pay an Excise Tax to the federal government equal to 2 percent of their net investment income. Subject to some limitations, private foundations can qualify for a lower tax rate. If, in a given year, a foundation's payout rate – its distributions as a percentage of average assets – exceeds the average payout rate for the preceding five years, then the tax rate is cut to 1 percent.

Though designed with good intentions, this current two-tier provision has created three unintended negative consequences as foundations seek to be as tax-efficient as possible in order to preserve resources for making grants.

- **It discourages foundations from giving more in a particular year based on need.** Because higher giving in any one year increases the rolling average for the next five years, making it harder to qualify for the 1 percent rate going forward, the current rule incentivizes steady, year-to-year payouts – regardless of whether it would make sense to boost the payout in a particular year to create more positive impact or better respond to a particular social need.
- **It imposes an administrative burden.** The two-tier provision creates an administrative burden that diverts foundations from their social mission. Many private foundations must calculate annually the two level excise tax. It is our experience that considerable time and money is spent every year ensuring the amount spent by the end of the year is neither too high nor too low, thus allocating valuable resources to accountants and lawyers rather than to grantees. I have attached as Exhibit 1 an illustration of the excise tax calculation from the 2012 IRS Form 990-PF for Wallace under the current rules compared to under our proposed tax simplification. The difference is clear.
- **It creates an incentive to cut contributions in tough times.** When a foundation's assets drop in value, it subjects itself to higher tax rates in future years unless it also reduces the dollar amount of its giving, because a high distribution rate in one year makes it more difficult to qualify for the lower rate during the next 5 years. Periods of market downturns often coincide with tougher economic times when disadvantaged children and nonprofits need increased support the most. Case in point: In 2008 Wallace's

endowment fell 30 percent, we laid off half the staff and cut back on grantmaking. The excise tax was one incentive to lay people off. The layoffs made it difficult to ramp up our grantmaking once there was a rebound in the value of the endowment. Market volatility is difficult because you don't have the people to ramp back up which results in less giving to organizations in need.

We favor a flat-tax rate that would be *revenue neutral*. We are not seeking a reduced tax burden, but rather a *simplified tax process*. Using the most recently available data on the IRS Statistics of Income Division website, we calculated the flat tax rate that would have created revenue neutrality over the five year period from 2007 to 2011, using a methodology from a recent study by Cambridge Associates. The calculations are attached. That rate is 1.39%, which is what we suggest the new flat rate be.

Excise tax simplification would create multiple benefits by:

- Eliminating a disincentive for grantmakers to give more during times of great need.
- Reducing the administrative burden on foundations, as well as agency monitoring costs.
- Simplifying tax planning, especially for smaller private foundations that may lack resources for complex financial planning, and which data shows are more likely to pay at the 2 percent rate than their larger peers.
- Reducing monitoring and enforcement costs to the Treasury Department.

In short, simplifying this complex tax will free up private foundations, such as Wallace, to invest fewer resources in managing payouts in order to avoid a tax penalty and instead focus their efforts on creating greater benefits for communities in New York State and elsewhere.

Excise Taxes on the Current Form 990-PF

Part V Qualification Under Section 4940(e) for Reduced Tax on Net Investment Income			
(For optional use by domestic private foundations subject to the section 4940(a) tax on net investment income.)			
If section 4940(d)(2) applies, leave this part blank.			
Was the foundation liable for the section 4942 tax on the distributable amount of any year in the base period? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No			
If "Yes," the foundation does not qualify under section 4940(e). Do not complete this part.			
1 Enter the appropriate amount in each column for each year; see the instructions before making any entries.			
(a) Base period years Calendar year (or tax year beginning in)	(b) Adjusted qualifying distributions	(c) Net value of noncharitable-use assets	(d) Distribution ratio (column (b) divided by column (c))
2011	69,517,176.	1,380,035,331.	0.050373
2010	46,933,035.	1,296,310,573.	0.036205
2009	60,927,202.	1,154,565,495.	0.052771
2008	77,762,781.	1,446,867,119.	0.053746
2007	77,536,719.	1,657,867,985.	0.046769
2 Total of line 1, column (d)			0.239864
3 Average distribution ratio for the 5-year base period — divide the total on line 2 by 5, or by the number of years the foundation has been in existence if less than 5 years			0.047973
4 Enter the net value of noncharitable-use assets for 2012 from Part X, line 5		1,367,028,957.	
5 Multiply line 4 by line 3			65,580,480.
6 Enter 1% of net investment income (1% of Part I, line 27b)			481,112.
7 Add lines 5 and 6			66,061,592.
8 Enter qualifying distributions from Part XII, line 4			71,135,986.
If line 8 is equal to or greater than line 7, check the box in Part VI, line 1b, and complete that part using a 1% tax rate. See the Part VI instructions.			

Form 990-PF (2012) The Wallace Foundation		13-6183757	Page 4
Part VI Excise Tax Based on Investment Income (Section 4940(a), 4940(b), 4940(e), or 4948 — see instructions)			
1 a Exempt operating foundations described in section 4940(d)(2), check here <input type="checkbox"/> and enter 'N/A' on line 1. Date of ruling or determination letter: _____ (attach copy of letter if necessary — see instrs)			
b Domestic foundations that meet the section 4940(e) requirements in Part V, check here <input checked="" type="checkbox"/> and enter 1% of Part I, line 27b		1	481,112.
c All other domestic foundations enter 2% of line 27b. Exempt foreign organizations enter 4% of Part I, line 12, column (b)			
2 Tax under section 511 (domestic section 4947(a)(1) trusts and taxable foundations only. Others enter -0-)		2	0.
3 Add lines 1 and 2		3	481,112.
4 Subtitle A (income) tax (domestic section 4947(a)(1) trusts and taxable foundations only. Others enter -0-)		4	0.
5 Tax based on investment income. Subtract line 4 from line 3. If zero or less, enter -0-		5	481,112.
6 Credits/Payments:			
a 2012 estimated tax pmts and 2011 overpayment credited to 2012	6 a	1,000,000.	
b Exempt foreign organizations — tax withheld at source	6 b		
c Tax paid with application for extension of time to file (Form 8868)	6 c		
d Backup withholding erroneously withheld	6 d		
7 Total credits and payments. Add lines 6a through 6d	7	1,000,000.	
8 Enter any penalty for underpayment of estimated tax. Check here <input type="checkbox"/> if Form 2220 is attached	8		
9 Tax due. If the total of lines 5 and 8 is more than line 7, enter amount owed	9		0.
10 Overpayment. If line 7 is more than the total of lines 5 and 8, enter the amount overpaid	10		518,888.
11 Enter the amount of line 10 to be: Credited to 2013 estimated tax <input type="checkbox"/> 0. Refunded <input checked="" type="checkbox"/>	11		518,888.

Simplified Excise Taxes on the 990-PF Form

Part V would be eliminated

Part VI Excise Tax Based on Investment Income (Section 4940(a), 4940(b), 4940(e), or 4948—see instructions)			
1a	Exempt operating foundations described in section 4940(d)(2), check here <input type="checkbox"/> and enter "N/A" on line 1. Date of ruling or determination letter: _____ (attach copy of letter if necessary—see instructions)	1	668,745.
b	All other domestic foundations enter 1.39% of 27b . Exempt foreign organizations enter 4% of Part I, line 12, col. (b).		
2	Tax under section 511 (domestic section 4947(a)(1) trusts and taxable foundations only. Others enter -0-)	2	0.
3	Add lines 1 and 2	3	668,745.
4	Subtitle A (income) tax (domestic section 4947(a)(1) trusts and taxable foundations only. Others enter -0-)	4	0.
5	Tax based on investment income. Subtract line 4 from line 3. If zero or less, enter -0-	5	668,745
6	Credits/Payments:		
a	2014 estimated tax payments and 2013 overpayment credited to 2014	6a	1,000,000.
b	Exempt foreign organizations—tax withheld at source	6b	
c	Tax paid with application for extension of time to file (Form 8868)	6c	
d	Backup withholding erroneously withheld	6d	
7	Total credits and payments. Add lines 6a through 6d	7	1,000,000.
8	Enter any penalty for underpayment of estimated tax. Check here <input type="checkbox"/> if Form 2220 is attached	8	
9	Tax due. If the total of lines 5 and 8 is more than line 7, enter amount owed ▶	9	
10	Overpayment. If line 7 is more than the total of lines 5 and 8, enter the amount overpaid . . ▶	10	331,255.
11	Enter the amount of line 10 to be: Credited to 2015 estimated tax ▶ Refunded ▶	11	331,255.

Exhibit 2

Excise Tax for Non-operating Private Foundations in the U.S.

	Net Investment		
<u>Year</u>	<u>Income</u>	<u>Excise Tax</u>	<u>Percent</u>
2007	60,027,071	869,562	1.45%
2008	21,829,106	275,841	1.26%
2009	16,612,123	211,119	1.27%
2010	28,474,306	399,031	1.40%
2011	32,508,573	454,909	1.40%
5-Year	159,451,179	2,210,462	1.39%

Source: Internal Revenue Service's Statistics of Income Division. SOI publishes with a multi-year lag and the latest available statistics are for 2011. We employ the methodology used in Analysis of Federal Excise Tax by Cambridge Associates (March 2012).