

TAXES AND FOUNDATIONS: A 50TH ANNIVERSARY OVERVIEW

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ABSTRACT

Pervading the history and tax laws applying to foundations is a persistent suspicion of the wealthy and of concentrated power, while the battles between foundations and Congress largely center on who has control over the uses of wealth. Foundation laws, and by extension, laws proposed or enacted for donor advised funds and other charities, often develop on the basis of the administrative expedience possible with regulating endowments, but not reserves, real estate, and other assets. One consequence is wide inconsistency in actual and proposed tax treatment of wealth held across the charitable sector. Legislative actions also cannot be separated from catalysts in the wider political economy. While the 1969 legislation that still drives much of the current tax treatment of foundations is widely considered to have successfully limited abuses, it is not without its warts. Continued debates over the control of the use of endowments must carefully address administrative feasibility, efficiency, equity across charitable institutions, and whether the wealthy would exert even more control over society if reforms led them to hold more wealth privately by contributing less to charity.

If “a foolish consistency is the hobgoblin of little minds, adored by little statesmen and philosophers and [tax policy] divines,” then our tax policy legislators must stand tall and wise.¹ When it comes to tax policy both in general and in regard to charities and foundations, US legislators are often inconsistent and frequently treat similar entities unequally.

In examining briefly both the history and tax laws applied specifically to foundations but not usually to other charitable organizations, we find a few pervasive factors. One is a persistent suspicion of the wealthy, catalyzed at times by a foundation’s founder’s behavior both before and after its formation. Closely related is a suspicion of concentrated power, including donor concentration, which becomes codified into the very definition of a private, nonoperating foundation. The resulting battles between Congress and foundations (and at times between foundations and other charities) largely center on the issue of control over the uses of that wealth.

Often less noted, foundation tax law develops along with administrative expedience, including reporting capabilities and the natural legislative tendency to target entities that are or can be identified, grouped, talked about, and administered in a similar way.

These factors intertwine with changes in the political economy to serve as occasional catalysts for legislation affecting foundations and, more recently, for efforts to apply foundation-like restrictions to other charities. Unsurprisingly, these factors lead to many inconsistencies in the treatment of the charities, endowments, and donors. Anyone who has helped draft legislation knows well how arbitrary are the lines defining who and what must comply with specific laws.

In this report, we provide some economic and historical context to the issues surrounding the tax treatment of foundations. We first put the wealth issue into perspective by presenting current and historical data on the size and assets of foundations and how these compare with the wealth of American households and the nonprofit sector.

We next examine whether foundations are becoming more dominant over time and relate that issue to payout rates.

Then we briefly review in two parts the history and development of tax policy toward foundations: first, the early 20th century suspicion of philanthropy, foundations, and their wealthy founders, and second, how the public-charity versus private-philanthropy debate led to the Tax Reform Act of 1969.

Before turning to debates over specific mechanisms for regulating foundations and their donors, we examine the issue of *control*: its importance to donors and the public and how tax law attempts to balance to what degree public control of foundations could actually lead to greater private control by wealthy individuals over society.

These various strands inform our final section, where we briefly discuss six issues surrounding the tax treatment of foundations, endowments, and wealthy donors: taxing the wealthy; requiring payouts; taxing

endowments; inducing transparency; providing different limits for deductibility; and pulling donor-advised funds (DAFs) into the foundation orbit. Examining each of these tax or regulatory efforts reveals inconsistencies in the legal treatment of different types of charitable institutions and occasionally helps determine whether the focus on specific institutional forms (such as foundations) efficiently addresses the real or purported problem they intend to solve.

FOUNDATION SIZE AND ROLE IN SOCIETY

Foundations have an influential role in society largely because they can concentrate resources on issues they feel that other institutions, including government and businesses, ignore. But how large are they?

Candid, an organization analyzing US nonprofits, reports that in 2017, foundations had assets of \$1.014 trillion. Independent foundations held a bit over 80 percent of that total; corporate, community, and operating foundations held the remainder. The Board of Governors of the Federal Reserve System estimates in that same year, US households and charitable institutions held \$103.4 trillion in total net worth (and assets of \$118.9 trillion), so the foundation sector holds about 1 percent of the net worth of American society.

Foundation assets have increased in recent decades when measured relative to a gross domestic product (GDP) that reached \$19.4 trillion in 2017. This is partly in line with a recent bubbling of all household and charitable net worth relative to GDP. That is, combined household and nonprofit net worth never exceeded four times the US GDP from World War II through 1990; it exceeded more than five times the US GDP at the end of 2019 (Steuerle 2019).

By contrast, the 5,113 grantmaking foundations reporting to the Foundation Center in 1960 held about \$11.5 billion in 1958 (a number the center conjectured would not have changed much by adding about 7,000 foundations for which data were limited and that had median assets of \$10,000; Foundation Center 1960). The \$11.5 billion represents 0.60 percent of the net worth of households and nonprofit institutions; that share was 0.51 percent by 1975, doubled to about 1.0 percent by 1998, and leveled out thereafter (figure 1). Interestingly, the Ford Foundation held \$3.3 billion, or 29 percent of the aggregate foundation total, in 1958.

The number of grantmaking foundations rose from 27 in 1915 to a bit less than 1,500 in 1955 to nearly 22,000 in 1975, 57,000 in 2000, and roughly 86,000 from 2012 to 2017 (table 1). Factors affecting foundation formation include the imposition of much higher income tax rates in the 1930s and early 1940s; a slowdown following the Tax Reform Act of 1969 that many wealth advisers argued (incorrectly in our view) was extremely onerous; and, perhaps more recently, an increasing concentration of wealth.

Foundation assets can also be compared with the net worth of other parts of the charitable sector and, though data is sometimes available only on assets (rather than net worth) or reported on book value (but not market value) of assets like real estate, those limitations don't affect general conclusions about where foundations sit among wealthholding individuals and institutions.²

Table 1

Grantmaking Foundations in the United States

Year	Number of Foundations
1915	27
1926	179
1944	505
1964	6,007
1975	21,877
1985	25,639
1995	40,140
2005	71,079
2015	86,203
2017	86,124

Sources: Data provided by Candid (formerly Foundation Center) staff; Andrews (1963) for earlier years.

Split-Interest Trusts

In 2012, the last year for which we find relatively complete data from the IRS (Rosenmerkel 2014), there were 113,682 split-interest trusts. Charitable remainder annuity trusts reported \$6 billion (book value), charitable remainder unitrusts reported \$93 billion (market value), charitable lead trusts reported \$24 billion (book value), and pooled income funds reported \$1 billion (book value). That adds up to \$124 billion (about one-sixth of 1 percent, or .0017 percent, of household and nonprofit net worth in 2012), though only a portion of that represents the interest share expected to go to charity on an expected-value basis. All split interest trusts reported gross income of \$11.7 billion in that year.

Donor-Advised Funds

Compared with most other charities and with foundations themselves, DAFs in aggregate have recently had a very fast growth rate. Although their asset size is still only about one-eighth that of independent foundations (\$110 billion in 2017, or about one-tenth of 1 percent, or 0.106 percent, of household plus nonprofit net worth), their grantmaking has already attained a rate about one-third as large (table 2). Of course, many donors use DAFs as temporary vehicles to park money while the donor decides what to do. DAFs also provide a convenient deduction of up to 60 percent of adjusted gross income (that deduction was 50 percent of adjusted gross income before the TCJA), whereas contributions to foundations cannot exceed 30 percent. The payout rate of DAFs on average exceeds 20 percent, but that number includes DAFs paying out between 0 and 100 percent.

Table 2

Donor-Advised Funds versus Foundations: Number, Assets, and Grantmaking

		Donor-Advised Funds	Private Foundations
2017	Total Number	463,622	82,516
	Assets	\$110.01 B	\$855.81 B
	Grantmaking	\$19.08 B	\$49.50 B
2016	Total Number	289,478	80,988
	Assets	\$86.45 B	\$792.62 B
	Grantmaking	\$15.91 B	\$45.16 B
2015*	Total Number	272,845	79,489
	Assets	\$77.18 B	\$734.10 B
	Grantmaking	\$14.22 B	\$44.13 B

Source: National Philanthropic Trust (2018).

Endowments of Universities—the “Other” Taxed Endowment

Counting the endowments of charitable institutions can be misleading because other assets can in a sense be more “endowed” than what is formally accounted for as endowment. Should Harvard’s net worth be estimated by its endowment, or might not its significant ownership of much valuable property in Cambridge be considered as well?

Still, for those wishing to make comparisons among the two groups for which Congress now assesses an excise tax on investment income, we provide here some data on the endowments of higher educational institutions, only a few of which were assessed the tax. At the end of 2016, those educational institutions reported a market value for their endowments of \$542 billion (about six-tenths of 1 percent, or .0057 percent, of total household plus nonprofit net worth). About three quarters (\$401 billion) was held by the 120 institutions with the largest endowments, while five held close to one-quarter of the total: Harvard (\$36 billion), Yale (\$25 billion), the University of Texas System (\$24 billion), Stanford (\$22 billion), and Princeton \$22 billion; US Department of Education, National Center for Education Statistics 2018).

Net Worth of Nonprofit Organizations

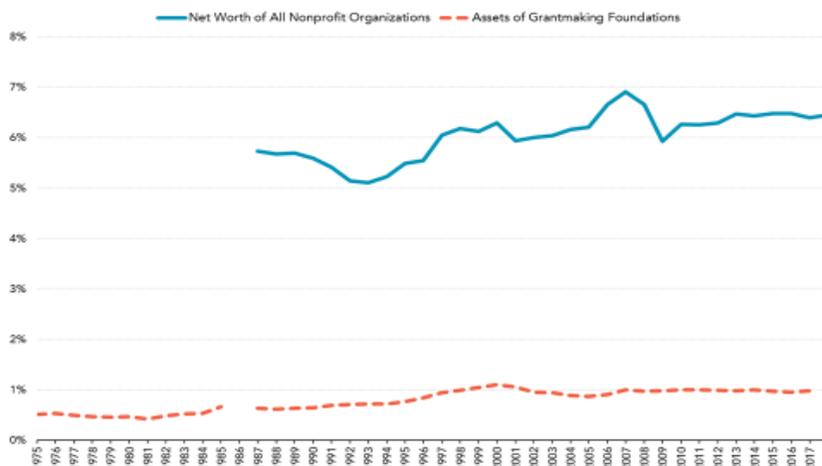
The net worth of all nonprofit organizations was estimated at the end of 2018 to be \$6.7 trillion (assets were \$8.8 trillion), representing 6.4 percent of the net worth of households and nonprofit institutions combined. Nonfinancial assets, mainly real estate, constituted at least 45 percent of total identifiable assets, though a bit less than one-fifth of assets were classified as unidentified miscellaneous assets. Thus, the foundation sector holds about one-sixth of the net worth of all nonprofit organizations (figures 1 and 2).

Figure 1

Financial Trends for Nonprofit Organizations



Percentage Share of Net Worth of Households and Nonprofit Organizations, 1975 - 2018



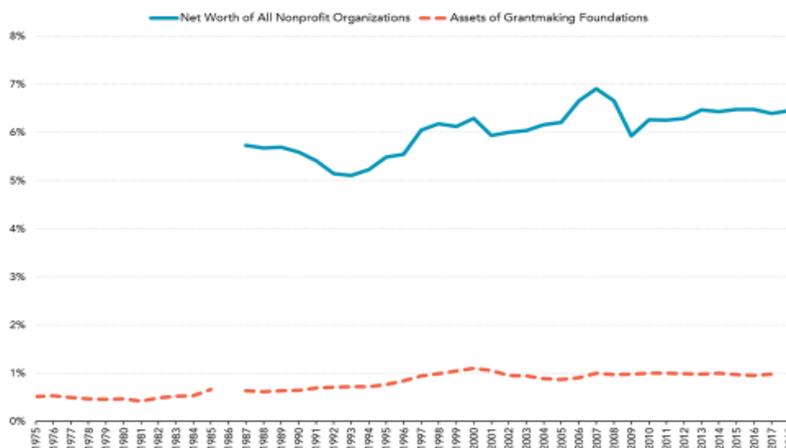
Sources: Board of Governors of the Federal Reserve System, Z.1 Financial Accounts of the United States (Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts), First Quarter 2019; Communications with Candid (various sources), Foundation Center, Foundation Stats, 2019; Analysis by C. Eugene Steuerle and Aravind Boddupalli.

Figure 2

Financial Trends for Nonprofit Organizations



Percentage Share of Net Worth of Households and Nonprofit Organizations, 1975 - 2018



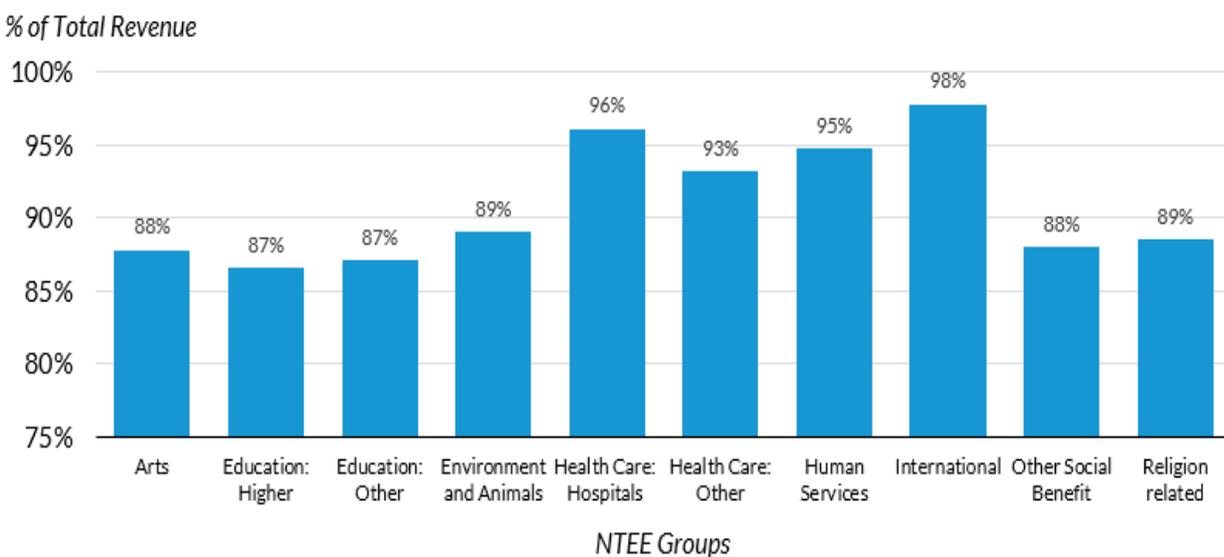
Sources: Board of Governors of the Federal Reserve System, Z.1 Financial Accounts of the United States (Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts), First Quarter 2019; Communications with Candid (various sources), Foundation Center, Foundation Stats, 2019; Analysis by C. Eugene Steuerle and Aravind Boddupalli.

Dependence on Operating Revenues and Contributions

Most charities do not depend upon returns from their financial assets. In figure 3, we break down by charitable subsector (as defined by the activity code from the National Taxonomy of Exempt Entities) the share of total revenues derived from sales, government grants, and contributions of those charities reporting on Form 990. The remaining dependence upon return from assets is low, though these data slightly overstate the case because the implicit returns from assets such as real estate and equipment are not counted in revenues.

Figure 3

Program Service Revenue, Government Grants, and Private Contributions of Public Charities as a share of Total Revenue by NTEE Group

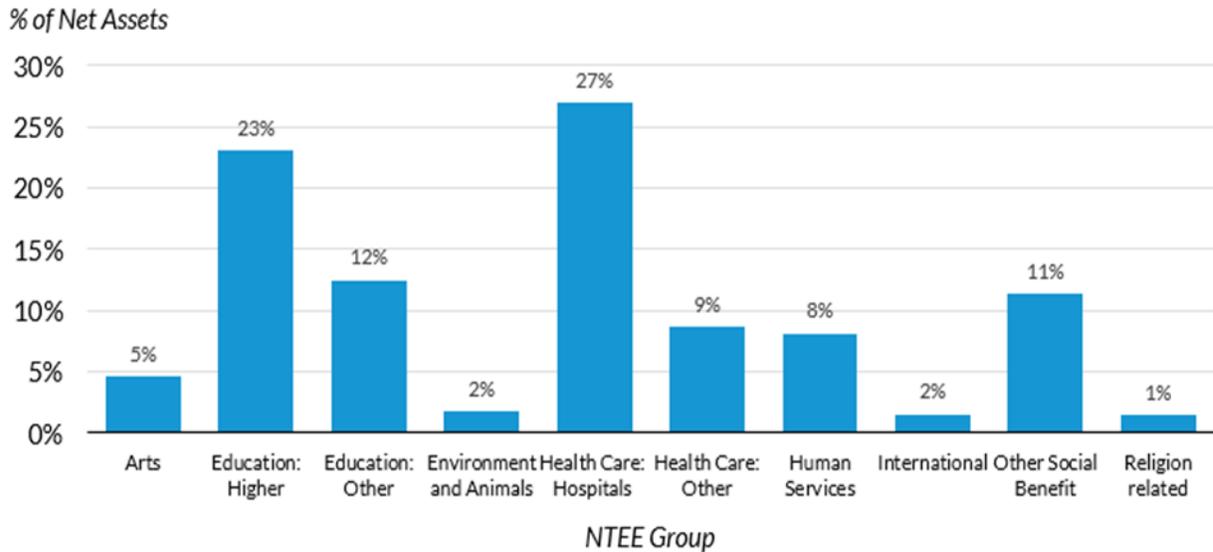


Source: NCCS Core File 2015.

Figure 4, in turn, shows the share of total net worth (as reported on Form 990 from tax returns) owned by each of these subsectors. In keeping with our theme that Congress often turns its attention to wealthier institutions, it is not surprising that Congress in 2017 added a tax on returns from endowments of some higher educational institutions and in the Affordable Care Act added extra reporting requirements on hospitals in the form of a community health needs assessment.³

Figure 4

Public Charity Net Assets by NTEE Group as a share of total Net Assets



URBAN INSTITUTE

Source: NCCS Core File 2015.

ARE FOUNDATIONS BECOMING EVER MORE DOMINANT?

One fear expressed before Congress passed the Tax Reform Act of 1969 was that foundations, by hoarding their wealth, were not simply failing to fulfill their charitable obligations by maintaining control over voting rights with donated assets; rather, they also threatened to grow much bigger and more dominant in society. The control enacted in 1969 was to force a payout rate that, after some amendments, homed in on a minimum rate of 5 percentage points, which is often considered a rough approximation of the real return earned on a balanced portfolio of assets. Consequently, each foundation would be unlikely to grow much in real terms (ignoring wealth valuation cycles), and each would likely decline over time relative to a growing economy with higher real asset values.

The concern over charitable hoarding has not gone away. A 2017 *Chronicle of Philanthropy* article claimed that several large charitable institutions indeed were hoarding their wealth.⁴ The examples in that article did not include foundations, which are our focus here, but emphasized institutions that saw an increase in value much greater than what they paid out.

As one author of this report pointed out many years ago in the research papers compiled for the Filer Commission and a *National Tax Journal* article (Steuerle 1977), even a high payout rate well above some average rate of return wouldn't wipe out the sector if new contributions were made. Using a simple formula that assumes constant values for (1) how much the payout rate exceeds or falls short of the rate of return on assets, and (2) the rate of growth of contributions or gifts received by foundations overall, it is possible to calculate a "steady state" of assets as a multiple of contributions (table 3).

With a low rate of growth of new contributions and a high rate of return relative to the payout rate, the sector could grow to 50 or 100 times the level of existing contributions. However, it turns out that the ratio in recent years has been about 14 (table 4). One explanation for this moderate size multiple is that average payout has typically exceeded about 6 percent in most years, while the rate of return on assets, at least as measured by the return on the multi-asset fund of the Investment Fund for Foundations, has typically fallen short of this average payout rate (figure 5).

Table 3
Net Worth of Foundation Sector Relative to Current Contributions

Payout rate minus rate of return on assets	Rate of growth of contributions or gifts received by foundations	Assets as a multiple of contributions
+.03	.02	20.4
+.03	.03	17.2
+.03	.04	14.9
+.02	.02	25.5
+.02	.03	20.6
+.02	.04	17.3
+.01	.02	34.0
+.01	.03	25.8
+.01	.04	20.8
0	.02	51
0	.03	34.3
0	.04	26.0
-.01	.02	102
-.01	.03	51.5
-.01	.04	34.7
-.02	.02	infinite
-.02	.03	103.0
-.02	.04	52.0

Source: Steuerle (1977). Table expanded for this report.

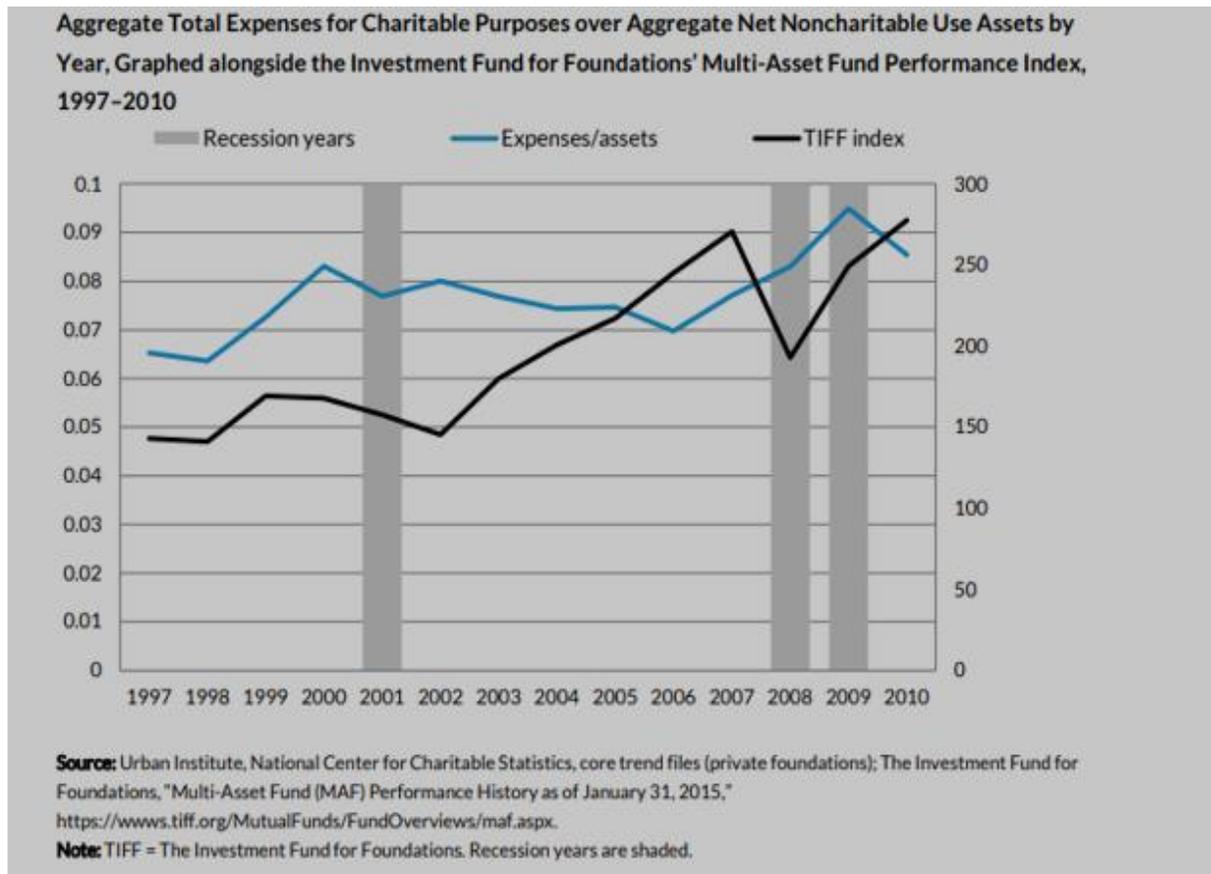
Table 4

Foundations: Number, Giving, Assets and Gifts Received, 2016 and 2017

	2016	2017	% Change
All Foundations			
No. of Foundations	85,987	86,124	0.2%
Total Giving	\$68,947,740	\$77,183,387	11.9%
Total Assets	\$907,624,520	\$1,013,522,727	11.7%
Gifts Received	\$57,499,816	\$72,993,192	26.9%
Independent			
No. of Foundations	79,132	79,351	0.3%
Total Giving	\$47,204,068	\$50,385,198	6.7%
Total Assets	\$741,859,310	\$827,081,687	11.5%
Gifts Received	\$33,413,244	\$41,573,818	24.4%
Corporate			
No. of Foundations	2,683	2,670	-0.5%
Total Giving	\$5,823,492	\$6,457,266	10.9%
Total Assets	\$29,622,190	\$31,672,887	6.9%
Gifts Received	\$4,981,693	\$7,285,688	46.2%
Community			
No. of Foundations	795	792	-0.4%
Total Giving	\$7,813,526	\$9,248,648	18.4%
Total Assets	\$89,565,234	\$102,626,410	14.6%
Gifts Received	\$9,648,459	\$11,518,148	19.4%
Operating			
No. of Foundations	3,377	3,311	-2.0%
Total Giving	\$8,106,654	\$11,092,275	36.8%
Total Assets	\$46,577,786	\$52,141,744	11.9%
Gifts Received	\$9,456,420	\$12,615,538	33.4%

Source: Data provided to the author by Candid (formerly Foundation Center) staff.

Figure 5



However, just as with other charities, what is happening to foundations as a subsector does not tell us whether individual foundations might be growing in relative wealth and influence. When measured relative to its share of societal wealth, a foundation living off its past contributions can only become more dominant in an economy with growing GDP if its net rate of return from earnings, realized and unrealized, exceeds its payout rate by more than the GDP growth rate. Nominal growth in GDP has recently been running as low as 4 percent. In this simple example, a foundation would need to earn more than 9 percent nominal (including unrealized gains) each year to grow relative to the size of the economy when paying out the minimum of 5 percent.

An aggressive investment portfolio might achieve that goal on average over many years, but most foundations do not maintain that type of portfolio. A warning to those making comparisons over a few years rather than over decades: wealth appreciation and depreciation cycles can be quite extensive; see the discussion of post-1990 bubbles earlier in this report. Any analysis of foundation or charity "hoarding" must try to account for these cycles.

A BRIEF HISTORY OF THE TAX TREATMENT OF FOUNDATIONS

One need not look hard to discover how the tax treatment of foundations and the development of the modern income tax itself are analogous.

Tax reform in the form of higher rates and regulatory control on the private use of resources has often focused on the wealthy and the organizations they are associated with. Even after the federal individual income tax was made constitutional by the Sixteenth Amendment, the corporate tax largely dominated tax collections up until World War II.

But why a corporate tax? Doesn't everyone recognize that businesses don't pay taxes, individuals do? Corporations were under suspicion. They controlled much of society's wealth and had grown enormously throughout the previous decades of industrial revolution, massively displaced employment on the farm, and included many trusts and monopolies considered to be anticompetitive. Not that the lines between corporations and partnerships or individuals were by any means pure from a theoretical standpoint.

A little-recognized aspect of the maturity of income taxation into a major revenue source in the 20th century was its administrability; only in the new industrial economy did larger organizations, mainly corporations rather than small businesses, adopt the modern accounting systems to which the tax authorities could attach themselves. Economic textbooks often deride the inefficiency of the tariff, but they fail to note why it existed for millennia: shipping often required a verifiable, private accounting among sellers, shippers or freight carriers, and buyers as to exactly what was being produced, shipped, and bought. When ships docked and bills of lading were checked, governments could latch their tax accounting onto this private accounting system.

Similarly, the modern large business organization had to account for innumerable transactions. Accurate accounting did not merely limit fraud in far-flung parts of an organization; it provided the business a means to assess at many different margins just which activities, plants, and groups were profitable. And owners, particularly in liquid markets, didn't want their profits understated. Even today, despite legal and sometimes illegal use of tax shelters, IRS estimates much higher compliance rates for larger organizations than for the self-employed, who still understate net income by around one-half.

An analogy can be made with the foundation. Besides being associated mainly with wealthy philanthropists, foundations' assets are largely marketable and easily valued. Thus, they maintain accounts in a way that returns on assets and rules for payout can easily be assessed.

The focus on the wealthy and on what might be administrable carries forward to today. The Obama administration and Democratic candidates in the 2016 and 2020 presidential election enacted and then further argued for taxes only on higher-income individuals, defined often as those with income above \$250,000 or \$400,000. A wealth tax proposed in 2019 by Senator Elizabeth Warren, among others, would apply only to those with very great wealth. Given the lack of any large existing reliable accounting system for wealth, a more

universal wealth tax would create substantial administrative problems if imposed on more than a few people. A similar logic applies to exempting most of the population from an estate tax.

The Tax Reform Act of 1969 largely focused on those with substantial income or wealth. Although our focus here is on foundations, the catalysts to that legislation came from both a Treasury study on foundations and other work on the failure of many high-income individuals to pay any tax (Committee on Ways and Means and Senate Finance Committee 1969).

Once Congress decides to concentrate its new restrictions or taxes by focusing on a particular group of individuals or organizations rather than on a particular behavior, the dividing lines become somewhat arbitrary. Why should low-income individuals pay double tax through the corporate tax? Why should phase-ins and phase-outs arbitrarily set new marginal rates? And, as we discuss in a later section, why should concern over endowments be leveled at only certain nonprofit institutions?

Let's now turn to a brief history of foundation tax law and see how three elements common to other tax developments (suspicion of the wealthy, suspicion of concentration of power, and administrative expedience) interact with specific historical developments to produce the 1969 rules applying to foundations.

THE EARLY 20TH CENTURY SUSPICION OF PHILANTHROPIC FOUNDATIONS

In many respects, the history of debates over the regulation of private foundations has revolved around the question of their distinctiveness. Critics have targeted foundations as exceptional in their susceptibility to abuse and in the dangers they pose to democratic norms and institutions. Defenders of foundations, on the other hand, have often stressed their consanguinity with other tax-exempt institutions and have said that targeting foundations is unjust and an assault on the "pluralism" that represents one of the sector's cardinal values (Brilliant 2000). As David Hammack has written, "Whenever a challenge to their legitimacy has arisen, American commitments to private property, corporate autonomy, separation of church and state, and the values of the First Amendment have allowed foundation leaders to head them off by taking steps to tie foundations more closely" to nonprofit organizations more generally (Hammack 2006, 53).

For much of American history, different regulatory and legal treatment of voluntary or nonprofit institutions did not hinge on specific institutional forms. Nor, as a corollary, did the law formally define some line between foundations and other nonprofit institutions. Other dimensions were the focus. In the 19th century, for instance, many states capped endowment sizes when granting charters to associations or institutions and privileged certain forms of associational activity (i.e., charitable, religious, or educational) over others (i.e., the partisan or political, or those promoted by disfavored groups such as laborers, women, or free black people; see Bloch and Lamoreaux 2017).

Yet by the mid-20th century, as the tax code developed a finer classification system of tax-exempt organizations, the private foundation began to attract special regulatory treatment. As mentioned, it would

continue to do so in the decades to come through the convergence of several dynamics. The first was increased attention to the distinctive intrinsic elements of the foundation form, particularly its reliance on a small circle of funders and on an endowment, that predisposed foundations to abuses or practices deemed contravene charitable purposes. Second was a complement to the foundation's reliance on a small subset of wealthy donors for revenue: when those donors were already suspect, usually for the ways they acquired or used their wealth, the public transferred their suspicions to the institutions they funded and at times called for heightened scrutiny. Compared with other nonprofit institutions, foundations proved themselves especially sensitive to public attitudes toward their funders. They often served as a screen on which to project anxieties regarding the schemes of some suspect elite cohort. In varying degrees, these two factors were always present with foundations, but the impulse for regulatory discrimination toward the entire class or some subset of them was often activated by external events or by broader political or economic developments. The climate has had to be right.

It was not until the Tax Reform Act of 1969 that private foundations were officially defined in the tax code (Joint Committee on Taxation 2005), so a discussion of their differential regulatory treatment might begin there. (The act defined them *negatively* as those organizations exempt from income tax under section 501(c)(3) of the Internal Revenue Code that also did not meet the tests for broad-based public support that determined "public charity" status; see Labovitz 1974). In actuality, the partiality toward public charities and against private foundations had been injected into legislation several decades before this. And even earlier, foundations had been the target of Congressional scrutiny even if that scrutiny did not lead to targeted legislation. That focus was at times rooted in distinctive elements of the foundation form as it had emerged in the United States by the 20th century—that is, as an endowed, general-purpose, grant-making institution. But at other times, the scrutiny stemmed more from particular contentious historical developments in which foundations were entangled.

The earliest opportunity for government targeting of foundations and the articulation of their exceptionally problematic nature was provided by efforts to secure federal charters, and particularly by the Rockefeller Foundation's effort to obtain such a charter. Like many subsequent episodes in which private foundations attracted special regulatory attention, the controversy surrounding the Rockefeller Foundation charter combined an absolutist critique of the foundation form with a particularist attack on a single individual or institution.

In March 1910, at the behest of Rockefeller's office, New Hampshire senator Jacob Gallinger introduced a bill to incorporate the Rockefeller Foundation. Rockefeller's staff was fairly optimistic that it would pass. Some 34 organizations had secured incorporation by Congress between 1889 and 1907; these included the Rockefeller-funded General Education Board (1903), the Carnegie Institution (1904) and the Carnegie Foundation for the Advancement of Teaching (1906). When Congress had granted charters to these foundations, it did so with little or no debate and without the sense that these institutions by their very natures carried potential threats that required special attention (Lankford 1964; Soskis 2010).

But such apprehensions dominated the proceedings when Congress considered (and ultimately rejected) the charter for the Rockefeller Foundation (which later received its charter from New York State). The episode has been covered in depth elsewhere (Sealander 1997; Soskis 2010; Reich 2018) and we need not recount its details. It is worth noting, however, that the reasons offered for the rejection of the charter demonstrate the entanglement of the two different approaches to foundation regulation mentioned earlier: the absolutist critical orientation and the particularistic one.

Of the two, the latter was dominant. At the time of the controversy, because of a series of muckraking exposés and the beginning of antitrust proceedings against Standard Oil, Rockefeller was one of the most hated men in America. His foundation attracted scrutiny because it had his name attached to it and because legislators suspected it was an effort to burnish that name and thereby stave off further regulation. As one Chicago newspaper commented, Rockefeller was so despised by much of the public that if he would have announced his plan to give up his business and retire to a monastery, they would have denounced his nefarious plot.⁵ The amount Rockefeller had seeded the foundation with at the time of the request—some \$100 million worth of Standard Oil stock—also generated considerable disquiet. He had endowed the Carnegie with \$10 million in bonds and established the General Education Board with a gift of \$1 million. Colleges and universities had just begun to build endowments as a mark of status, and according to one tally, the value of *all* higher education endowments in the United States in 1900 was less than \$200 million. So the Rockefeller Foundation represented a massive new feature of the charitable landscape as well as a massive new target (Kimball and Johnson 2012; Lankford 1964; Reich 2018).

Besides its size, the Rockefeller foundation's expansive scope and its specifically national character also generated suspicion: opponents regarded it as a direct challenge to federal authority, an unaccountable institution set on establishing a rival center of national power. Accordingly, attacking the foundation and denying the foundation's charter became a way to uphold the potential of federal authority. It represented the institutional embodiment of private power that the government would restrain. Attacking the foundation was good politics, too, and so legislators maintained their assault even after Rockefeller offered a host of concessions—including a term limit or limited life for the foundation, an endowment cap, and the establishment of a body of prominent public citizens that would have veto power over the election of future board members—that would have changed the course of philanthropic history had they been adopted (Soskis 2010; Reich 2018).⁶

Ultimately, critics' concerns with the Rockefeller Foundation's potential as an instrument of plutocratic power overwhelmed considerations of how inherent those dangers were in the foundation form itself. If power was the issue, then that power could be channeled through a range of private institutions and it was the power, as opposed to the institutions themselves, that required close regulation or control. In fact, during this period, critics often discussed foundations as part of a broader network of elite-controlled institutions, a "charity trust" that included universities, research institutions and certain elite-dominated social-service organizations (Soskis 2010). Still, when a federal commission, led by St. Louis attorney Frank Walsh, investigated foundations as part

of a broader inquiry into the roots of labor violence, the recommendations it issued treated foundations as exceptional threats to American democracy. It proposed a Congressional statute requiring that all “incorporated non-profit-making bodies whose present charters empower them to perform more than a specific single function and whose funds exceed one million dollars,” secure a federal charter, which, among other restrictions, would limit foundations funds to the amount held at the passage of the act of incorporation and prevent the expenditure of more than 10 percent of the principal in any one year (Soskis 2010).

The leadership teams of the Rockefeller Foundation and the other large foundations were chastened by these early attacks. Over the next several decades, they sought to avoid antagonizing policymakers by cultivating an air of political disinterest. This discretion likely worked: for the next several decades, Congress focused little attention on private foundations as a class of institution requiring special scrutiny (Lankford 1964). It was not until the 1950s that this scrutiny returned, a development that can be attributed to several historical factors (that underscores how much the different regulatory and legal treatment of foundations often rested upon factors exogenous to the foundation form itself).

Most importantly, beginning in the 1940s, the number of philanthropic foundations, and especially small family trusts, surged, from some 27 in 1915 to 4,162 in 1955 (Lankford 1964; Duquette 2019). The private wealth generated by the post-World War II boom, coupled with the incentives provided by sharply increasing income and estate tax rates (which were enacted first to meet the demands of the Depression and World War II, then extended to meet the demands on the US as the world’s dominant economic and greatest military power) led a proliferating corps of tax lawyers and wealth advisers to encourage their clients to consider foundations as exceptionally effective vehicles of tax minimization (Troyer 2000). This growth, and especially the increased use of foundations as a means of preserving family control over businesses and as tools of insider dealing, provoked Congressional scrutiny. So too did shifts in the political climate: the rise in anticommunist and reactionary thinking led some critics to focus on what they perceived to be the internationalism and radicalism championed by certain leading foundations.

In 1952, Congress established a select committee to investigate foundations, led by Georgia Democratic congressman Edward Cox. As the committee’s counsel explained, when foundations were the objects of public scrutiny in the first decades of the century, “the fear that was expressed everywhere was that the foundations would be the tool of reaction...that they would crush the labor unions, that they would attempt to impose a rigid form of economy on this country, which would maintain the status quo” (Lankford 1964, 34) But in 1952, “the most articulately expressed fear has been that the foundations have swung from that position far to the left, and now they are endangering our existing capitalistic structure” (34).

The plasticity and pliability of the fears associated with foundations has been one of the defining features of their place in public opinion; it can perhaps signal to us the possibility that critics targeting them were attracted less to the particular details of the menace described, shaped by the politics of the moment, but to some deeper, common, intrinsic feature. Although Cox himself did not specify what this feature might be, he made

clear that he believed foundations to be exceptionally problematic. He insisted on leading a special committee rather than deferring to the Ways & Means Committee because he wanted to focus especially on foundations and not on tax-exempt organizations more generally (Lankford 1964), even those that might be more influential than many foundations.

And yet during the investigation, Cox made sure to emphasize that he did not seek to indict *all* foundations. He claimed not to be interested in those that “restricted themselves to health, medical research and popular culture.” He would only focus on those dealing with the “fields of social reform and international relations” (Lankford 1964, 35): the Rockefeller Foundation, for instance, whose work in China he accused of helping to lose the country to communism, and the Rosenwald Fund, which he attacked for stirring up “class and race dissension” in the region (Lankford 1964, 36).

Two years later, Representative B. Carroll Reece, a Republican from Tennessee, took up another investigation into foundations, which he dedicated to exposing the “subversive” activity they harbored. As Reece declared on the House floor, “Some of these institutions support efforts to overthrow our government and to undermine our American way of life” (Zunz 2012, 194). Ironically, given the concerns of the early Progressive Party critics of foundations, Reece raised alarms about the ways that foundations, working as an ally of the federal government, sought to wean Americans off their local attachments (Lankford 1964). He also saw foundation funding as central to an interlocking network of research organizations that had the pernicious power to shape public opinion in progressive directions, including the American Council of Learned Societies and the Social Science Research Council (Zunz 2012). Of course, private donations could also support these organizations; there was nothing unique about the foundation form that necessarily installed them within the center of that network of influence. And the reforms that Reece proposed were mostly limited to restricting foundation funding to nonsubversive beneficiaries. Ultimately, in these midcentury congressional investigations, heightened scrutiny was justified not by reference to the intrinsic features of foundations but by how certain political factions had been utilizing them.

PUBLIC CHARITY VERSUS PRIVATE PHILANTHROPY AND THE TAX REFORM ACT OF 1969

At roughly the same time that these investigations were unfolding, however, the federal government began making distinctions in regulating tax-exempt organizations and highlighting structural dangers within the foundation form that justified different treatment. These features were most clearly exposed through the contrast established between private foundations and public charities. As early as 1943, Congress passed legislation requiring tax-exempt organizations to file annual information returns but then exempted churches, schools and colleges, and publicly supported charitable organizations. This carve-out suggested that institutions that depended on a small set of donors, and were thus freed from a reliance on the public, required greater public scrutiny (Brilliant 2000; Fremont-Smith 2004). According to the scholar Eleanor Brilliant, this represents

the first statutory distinction made between philanthropic foundations and publicly supported charitable organizations (Brilliant 2000, 16).

This distinction would be deepened in law over the coming decades. The Revenue Act of 1950, for instance, exempted this same group of favored charities from strict penalties, including loss of exemption, for certain self-dealing transactions and unreasonable accumulations of income, under the assumption that their reliance on the public for donations would make such abuses unlikely to occur (Troyer 2000; Fremont-Smith 2004). These reforms were as much signs of misgivings toward foundation activity as they were expressions of support for publicly supported charities. Legislators were clearly influenced by Treasury investigations that showed the prevalence of insider dealings and problematic relations with family businesses among private foundations.

Yet the contrast established with public charities helped tether this observed proclivity to abuse to a structural debility within foundations' design. Thomas Troyer, a lawyer who worked in the Treasury office of Tax Policy during these years and helped shape the department's policy toward foundations, noted that through the comparison with public charities it became clear that "the very nature of the private foundation made it peculiarly vulnerable to use for personal purposes." He further wrote, "Open to creation and domination by one donor or one family and, after the death of an individual donor, subject to no requirement that its governing board ever include any independent party, the private foundation was uniquely suited to the personal, non-charitable uses manifested in the self-dealing, payout failure, and business holdings abuses" (Troyer 2000, 63–64). This distinction did not suggest that public charities were incapable of committing similar abuses, but these transgressions, if they occurred, were not deemed symptomatic of some structural debility and so did not merit different regulatory scrutiny.⁷ Note the Treasury's shift in emphasis, focusing more on the efficiency and equity of the foundation's activities and less on the power or influence of the foundations or their donors over social reform.

If the contrast with public charities pointed to potential rationales for targeted regulatory scrutiny of foundations, the case was made more explicit in the deliberations leading to the Tax Reform Act of 1969. Yet as in the past, absolutist and particularist critiques combined in ways that obscured the fundamental nature of those rationales.

The 1960s brought another surge in congressional scrutiny toward philanthropic foundations. In 1961, prompted by the "disproportionately rapid growth" of foundations and the billions they removed from taxation, Texas congressman Wright Patman, chair of the House Committee on Banking and Small Business, began his own investigation (Brilliant 2000, 24; Zunz 2012). He was especially concerned with how foundations were able to use their tax-exempt status to compete unfairly with small business. He trained his sights on the Hartford Foundation, for example, which controlled more than a third of stock in the Great Atlantic & Pacific Tea Company (a company that he believed to be a particular threat to small businesses and that he had targeted with legislation in the past). A fiery populist, Patman regarded foundations as a tool the wealthy employed to preserve their own class interests; he highlighted the use of foundations to retain control of businesses in the

hands of a single family (with the Ford Foundation, which was by far the dominant foundation by asset size at that time, serving as the most glaring example). He was also a committed isolationist and racist, and he opposed liberal foundations for their work promoting internationalism and civil rights.

For all Patman's theatrics, the investigations that he initiated through the select committee that he chaired did uncover substantial abuse among foundations. These revelations, coming at a moment of mounting concern about a shrinking tax base, fueled a desire among legislators to pursue a more aggressive regulatory stance toward foundations. The Treasury Department, which had little sympathy for Patman, also understood it needed to respond to his committee's findings. In 1965, it issued its own report based on a survey of philanthropic foundations, including all with assets of over \$10 million. In the balance it struck, the report reflected the comment that President Kennedy had made when asked about Patman's investigations; he stated that foundations were good, but that tax evasion was bad (Duquette 2019, 571).

In the same manner, Treasury sought to address foundation abuses without jeopardizing the "special and vital role" private philanthropic organizations played in the United States, "initiat[ing] thought and action, experiment[ing] with new and untried ventures, dissent[ing] from prevailing attitudes, and act[ing] quickly and flexibly" (United States Senate Committee on Finance 1965, 5). It identified six "major problems" associated with foundations: self-dealing, the delay in benefit to charity, foundation involvement in business, family use of foundations to control corporate and other property, financial transactions unrelated to charitable functions, and donor involvement in foundation management (United States Senate Committee on Finance 1965, 6–9). The report also took pains to emphasize that these problems were restricted to a small class of (mostly smaller, family) foundations and that the majority had been found compliant with both the spirit and letter of the law. The report concluded with a series of proposed reforms—including a prohibition on self-dealing, a requirement that nonoperating foundations distribute their income by the end of the following year, and limits on foundation involvement in active business—that clearly addressed the "major problems" associated with the small class of offenders.

The momentum toward major tax reform increased after the publication of the Treasury report; during that period, the focus on private foundations as especially problematic organizations intensified. A series of provocations amplified the understanding of private foundations as carrying an intrinsic proclivity to abuse that had been cultivated through the contrast to public charities. Simultaneously, the Treasury had begun to study high-income taxpayers who paid little or no tax (Committee on Ways and Means and Senate Finance Committee 1969). Those two efforts spurred a movement for tax reform, focused particularly on the wealthy and the charitable institutions they created, that carried forth from the Democratic administration of Lyndon Johnson to the Republican administration of Richard Nixon.

When in February 1969 the House Ways and Means Committee finally began hearings on a tax reform bill, the first issue it addressed was tax-exempt foundations, and the first witness called was none other than Wright Patman (Brilliant 2000). One of the issues raised in the hearings was foundation political activism, which

implicated a different subset of foundations—the largest, highest-profile institutions—than did self-dealing, most often associated with smaller, family foundations. Over the course of congressional deliberations over the Tax Reform Act, the Ford Foundation came under special scrutiny, in part because of political activities that antagonized critics. Especially troubling to some legislators were the foundation’s decision to offer fellowships to Robert Kennedy’s aides after the senator’s assassination in 1968; its support for certain more radical civil rights organizations, and especially for the Congress of Racial Equality’s voter registration drives, which led to the election of the first African-American mayor in Cleveland; and its involvement in a controversial school-decentralization program in the Ocean Hill School District in Bedford–Stuyvesant, New York. The foundation’s ability to initiate thought and action, experiment with new and untried ventures, dissent from prevailing attitudes, and act quickly and flexibly could be a source of alarm as much as of celebration. Patman wondered whether Ford had a “grandiose design to bring vast, political, economic, and social changes to the nation?” (Zunz 2012, 224). The high-handed testimony given by Ford president McGeorge Bundy in the foundation hearings did little to assuage these views and might have provoked support for more aggressive regulation (Zunz 2012).

Yet in all the concerns raised about the excesses and potential abuses of philanthropic power, the extent to which they stemmed from specific characteristics of the foundation form that required targeted regulation, and differential treatment was never clearly articulated as a rationale for action. In fact, the restrictions on foundation participation in political campaigns and voter registration imposed by the Tax Reform Act of 1969 were eventually extended to all 501(c)(3) organizations (Troyer 2000).

Indeed, as Thomas Troyer has noted, several of the regulations that were targeted at foundations in the Tax Reform Act, such as the excise tax and the reduction of the charitable deduction for contributions of capital gain property, were not clearly linked in the legislative debate to specific foundation abuses that needed to be checked or to specific structural debilities that needed to be reformed. Instead, Troyer argues, they seemed to spring “from a penumbra of congressional mistrust of foundations” (Troyer 2000, 61). Foundation defenders, such as Carnegie Corporation president Alan Pifer, noted that the excise tax posed a fundamental challenge to the entire idea of tax exemption that had united the nonprofit sector, or at least it seemed to place foundations outside that sector’s protective borders (Brilliant 2000).

Other regulations contained within the act had a clearer connection to the distinctiveness of the foundation form and so could root their rationales to it. A 6 percent (now 5 percent) payout ratio, and a briefly considered 40-year lifetime limit, stemmed from widespread concerns that charities were starved for resources and that endowed grant-making institutions imposed a “delay in benefit to charity,” in the words of the Treasury report. Note, however, that two dangers meant to be addressed by these reforms—perpetuity and a reliance on an endowment—could be found in other institutions but seemed to carry special dangers when associated with a private grantmaking foundation. In this case, it was the “nonoperating” nature of the foundation that marked it as deserving of special treatment.

The Tax Reform Act of 1969 and the regulatory fusillade that it brought on foundations—from the payout rate, to restrictions on political activity, to reporting requirements, to the excise tax—was clearly the culmination of the misgivings that had been building about foundation activity for the past several decades. This context can lead to two different interpretations of this different regulatory treatment. First, lawmakers may have been so primed to the inherent dangers of the foundation form, and so sensitive to a series of provocations highlighting perceived foundation abuses, that regulation of some sort was all but inevitable: It was only a matter of time before the very nature of the private grantmaking foundation attracted the attention of lawmakers and regulators. This view might seem reasonable now, half a century after the act’s passage, but the focused regulatory pressure applied to foundations still caught many of the sector’s leaders by surprise. When the Congressional hearings began, for instance, the head of the Council on Foundations assumed that they would “probably only last a week” and that they would pass with little effect (Brilliant 2000, 67).

The other interpretation highlights the contingent nature of the focus on foundations, stressing how much the confluence of reports of various foundation abuses created a sense of crisis that might not have existed if those provocations had arrived at different moments or in different sequence. It raises a counterfactual: if Ford had not funded RFK acolytes; if McGeorge Bundy had managed to tame his imperiousness during congressional hearings; if the political moment had been less preoccupied with the tax base, perhaps foundations would have generated less attention and less regulation. Cox and Reece and Patman might have made their cases without turning to the tax code to address their sense of alarm and reflect on the distinctive, problematic nature of the foundation organization form. Of course, it’s impossible to assess this counterfactual, but it helps underscore to what degree the rationales for the regulation of foundations have been rooted as much in specific historical circumstances as in the intrinsic nature of foundations themselves.

Once public and political attention was turned to regulating foundations, it is not hard to see how drafters of specific legislation would be stymied in efforts to extend most rules to other nonprofit institutions even if they engaged in the same behavior and closely resembled a foundation in their activities or use of endowment. First, there was no political driving force. Second, drawing lines is difficult and, as we discuss below, drawing boundaries on the basis of a limited donor base and most assets lying within an endowment pool defines a set of institutions around which rules can more easily be enforced than institutions where revenues and endowments either come from or can easily be shifted to a nonregulated form.

THE ISSUE OF CONTROL

Who controls the direction of society and, within that society, the use of charitable funds? This question underlies much of the debate over foundations and, by extension, DAFs and other endowments. But before looking to some of the specific methods of control applied by the state to foundations, we must raise another “control” issue: to what degree tax laws affect individuals’ willingness to make charitable donations.

A study of wealthy people’s charitable giving patterns (Steuerle et al. 2019) finds that no matter what wealth class is examined (e.g., \$2 million to \$5 million, to \$100 million or more), no class gives away much more than about four-tenths of 1 percent of that wealth in any given year (table 5).⁸ The reasons for hanging onto wealth must vary by wealth class, because the excuses given the lesser wealthy classes (e.g., the fear of nursing home costs) simply don’t apply at higher wealth levels and are insurable to some extent anyway. But the desire for control doesn’t seem to go away as wealth increases.

Table 5

Average Decedents’ Charitable Contributions in 2006 as a Share of Net Estate, 2007

Net estate	Total number	Average net estate	Average charitable contributions before death, 2006	Average charitable contributions as a share of net estate
Under \$2 million	1,294	1,455,000	4,000	0.27%
\$2 million to under \$5 million	26,146	2,969,000	6,000	0.20%
\$5 million to under \$10 million	6,324	6,794,000	17,000	0.25%
\$10 million to under \$50 million	2,834	18,382,000	60,000	0.32%
\$50 million to under \$100 million	179	68,515,000	283,000	0.41%
\$100 million or more	112	304,104,000	1,314,000	0.43%

Source: Authors’ analysis based on a dataset created by the Statistics of Income Division of the Internal Revenue.

Only at death did we find a larger number (but still a significant minority) of individuals giving away amounts that had more than a small impact on the options provided to them or their families for maintaining ownership and control (table 6).

Table 6

Average Total Giving in the Last Five Years of Life and at Death, by Wealth Level

Net estate	Average total giving, 2002-06	Average estate giving	Estate giving as a multiple of 2002-06 giving
Under \$2 million	20,000	14,000	0.7
\$2 million to under \$5 million	30,000	117,000	3.9
\$5 million to under \$10 million	90,000	452,000	5.0
\$10 million to under \$50 million	284,000	1,575,000	5.5
\$50 million to under \$100 million	1,254,000	12,425,000	9.9
\$100 million or more	6,987,000	143,100,000	20.5

Source: Authors' analysis based on a dataset created by the Statistics of Income Division of the Internal Revenue.

Source: Steuerle et al. (2019)

More anecdotal evidence tells us the same story. It's not uncommon to hear stories of people moving from lucrative jobs to lesser-paying jobs where they believe they fill a broader social purpose. They may give up making, say, \$500,000 as a professional lawyer to making \$50,000 as a schoolteacher. But how often do we hear of people making \$500,000 and giving away \$450,000? The sacrifice of resources would be the same in the two cases. The explanation, again, seems to center on control. The people taking the teaching jobs feel they are exercising control over their lives; they've exchanged money for something else they want out of life. Simply giving away the \$450,000 transfers control to someone at a charitable institution.

Yet again, many people seem quite content living in a society where they tax themselves to cover government spending and tax subsidies that total 40 percent or more of income (in the US, roughly speaking, 20 percent federal, 10 percent state and local, and 10 percent tax subsidies; see Steuerle et al. 2017). Yet in the US, people only give away about 2 percent of income,⁹ and that's a higher rate than in almost any other country. Perhaps this lesser reluctance to give up personal control comes from being "tied to the mast" with others.

This is where foundations, named buildings at major charitable institutions, and DAFs come into play. They bridge the divide between complete and zero control by offering the donor some feeling of control or exchange, real or imagined, over the use of the money, sometimes even after death. In that sense, options for this type of giving provide significant incentives beyond other forms of charitable giving, where almost all control is passed—or at least passed more quickly—to the staff of charitable organizations

The tendency to give out of income but not out of wealth, except occasionally in estate planning, is reinforced by limited incentives to act now rather than later. Many people with large or even moderate amounts

of wealth recognize less than 2 percent of their wealth as capital income in any one year (Bourne et al. 2018), so giving away 1 percent of wealth is often equivalent to giving away more than 50 percent of annual realized capital income. Thus, especially if labor income is modest, few wealthy people can give away very much of their wealth before they've hit some limit (30 percent, 50 percent, or 60 percent of adjusted gross income) on what is currently deductible. The returns on wealth can escape tax more easily if left in a charitable endowment rather than in a personal portfolio, but that incentive may not be great if one is accruing most returns without tax anyway.

If this is correct, then too strenuous an attack on various forms of donor control after a gift is made could lead to significant declines in giving. Some wealthy younger donors already see little tax advantage during life to give to a charity versus a controlled, not-profit-seeking business that operates charitably. The Chan-Zuckerberg initiative is one example, though estate tax considerations come into play later in life.¹⁰

STILL-SWIRLING POLICY ISSUES

Here we briefly examine six major areas of tax policy controversy into which foundations still get drawn: taxing the wealthy; requiring payouts; taxing endowments; inducing transparency; providing different limits for deductibility; and pulling DAFs into the foundation orbit.

Surrounding each of these issues is whether consistency in policy across charitable organizations should be sought, in which direction it should go, how much consistency matters, and whether policy could be administered even if consistency did matter.

Taxing Wealth

If the goal of policies toward foundations rests on a belief that too much power resides with the wealthy, then it is hard to see how taxes on foundations do much to achieve that goal. If much-stricter foundation rules would induce the wealthy to give less, they and their heirs might accrue even more wealth and attain far greater power than they would by giving away significant shares of that wealth.

Assuming a decent rate of return, which on stocks over time has been well above the rate of growth in the economy, it is easy to see how multigenerational dynasties can be formed. Because for the most part the US does not tax capital income at the individual level (Bourne et al. 2018), it is not hard for a family to accrue an increasing share of society's wealth over generations. Charitable contributions help ameliorate that tendency, and the allowance of some degree of control over the purposes of the charity help induce those contributions. A more direct way to reduce that power would be to tax the wealthy more, including by reducing the ways they can escape tax on realized and accrued capital gains and on capital income more generally through tax arbitrage, such as various ways of taking of deductions without recognizing receipts.

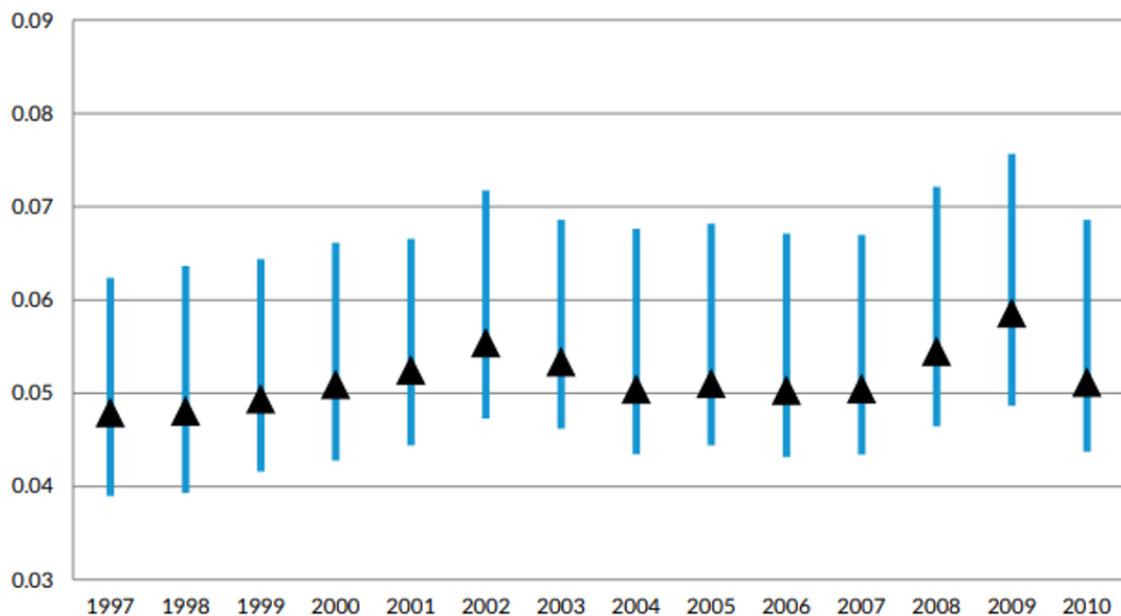
Requiring Payouts

The Tax Reform Act of 1969 addressed the problem Congress saw with wealthy people donating assets to foundations but then contributing little out of foundation endowments toward charitable causes. There is no pure economic case for or against charitable output now versus later, though there is one for allocating more in downturns and less in upturns. The public has the right to establish a payout rate in exchange for charitable contribution deductions, though it should avoid adding to the classic political bias against future generations who do not yet vote. Table 3 demonstrates that the rate of payout alone does not determine whether the charitable sector survives; as long as there are new contributions, it only determines the sector's relative size.

Although most of the larger and older individual foundations have not grown greatly in their relative command over societal wealth in recent decades, that doesn't mean they wouldn't hoard if they could, as many did before 1969. Indeed, even now, most foundations tend to heed quite closely to the minimum payout rate of around 5 percent (figure 6). A rate of 7 percent or more would easily put a foundation in the top quarter of foundations with the highest payout rates in almost any year. This suggests that foundations indeed have some tendency to hoard and worry about relative status and that tax laws exercise a major influence on how much most foundations pay out.

Figure 6

Distribution Rate for Foundations with Greater than \$10 Million in Assets, 1997–2010



Source: Urban Institute, National Center for Charitable Statistics, core trend files (private foundations)

Note: The triangle represents the median and the ends of the box plots represent the 25th and 75th percentiles of distribution

Source: Dietz et al. (2015).

The tendency to hoard, absent legal or societal pressures, applies to other endowed institutions as well. Harvard, Yale, and Princeton, at least historically, worry about their relative status, and it's hard to find a better explanation for their historic buildup of assets and endowment, a point made by Charles Elliot (Kimball and Johnson 2012). Of course, compounding investment returns for centuries certainly helps. Regardless, it is hard to apply payout rules consistently across all charitable institutions in the same way as for nonoperating charitable organizations that fulfill their mission mainly out of endowments.

Operating charities can easily use operating revenues to add to endowments to offset required payments out of endowments. Focusing on what is labeled as endowment doesn't usually help either, because many charities can also label assets as reserves, buy real estate, and perform other "payout sheltering" mechanisms. The data on charitable organizations (figure 3) show that most revenues come from program service revenues, government grants, and contributions rather than existing financial assets.

Further, a harsh rule on the endowment portion of an operating charity's portfolio likely would induce an additional layer of inefficiency. For instance, it would encourage excessive purchases of fixed real estate, which provides returns that are far less flexible than returns to financial assets. The art museum might put on an extra wing when it might have made better uses of its funds. One suspects that donors' "edifice complex" already creates a bias in favor of buildings.

Interestingly, had advocates against foundation endowments succeeded historically in requiring a strict limited life, then foundation grants or equivalent gifts by donors to today's operating charities might well be less than they are currently, because independent foundations now seem to be making as much or more grants than they receive in gifts (table 4). A very limited life could also reduce total charitable gifts by those donors, rather than simply converting potential new foundation gifts into donations to operating charities.

In today's world, after years of accumulation, any attempt to force foundations to quickly spend down their assets would be especially beneficial to a current generation that spends down charitable inheritances from the past and fails to leave an equivalent share to the future.

Taxing Endowments and Returns from Other Assets

Given the nature of the charitable deduction, there is clear tax favoritism for money saved within a charity versus money immediately spent directly for charitable output. The returns on gifts held in charitable solution receive a 100 percent charitable deduction not otherwise available to those who have hit some limit on charitable deductions—a condition that applies to many wealthy individuals.¹¹

Scholars such as Dan Halperin (2008) have made a case for the taxation of returns from endowments, treating them in an income tax like other income that is subject to tax. However, should consistency be sought by moving toward a system that taxes all income similarly, toward one that allows deductions or effective exclusions for all earnings devoted to charity, or, as we have now, something in between?

Our in-between world raises a further question: why pick on foundations and, more recently, a small subset of educational institutions with an “excise” or income tax on the returns from the endowments? An excuse made in legislative history was that the “excise” tax on foundation income was meant to finance support of tax administration of the charitable sector, but the money raised was never allocated to that promised purpose. Clearly, the attack here is on institutions thought to be controlled by the wealthy or benefitting an elite, but it’s a pretty arbitrary selection. In any case, these excises clearly reduce net charitable transfers going to transferees.

The design of the current foundation excise tax for a long time had an additional, unintended bind: it discouraged giving during economic downturns because a higher rate of giving in one year—as can be generated simply by maintaining the same nominal level of grants when portfolio value drops—generates a higher tax rate when the foundation returns to a more normal rate of giving (Steuerle and Sullivan 1995). Beginning in tax years after December 20, 2019, a flat rate of tax now applies.¹² Although that former disincentive to increase grantmaking was removed, the new rate is designed to collect about the same amount of tax over time.

Inducing Transparency

Certainly, citizens have a right to set the rules surrounding what activities they want to subsidize. Thus, rules on transparency by foundations make some sense. But yet again, what about other charitable organizations, or for that matter, individuals donating to noncharitable organizations?

A strong case can be made that Congress should and did intend to limit individuals’ ability to float subsidized contributions through charities for noncharitable, political purposes. But education, advocacy, and even lobbying can serve charitable purposes, and it is hard to distinguish among the three. This is a subject that extends far beyond this report. Our only point here is that one should try to seek some balance among different types of institutions while considering rights to privacy and what is administrable. Our sense (no proof offered) is that we haven’t gone too far afield in the foundation arena and that permeable boundaries still limit activities more than no boundaries at all. But it’s not at all clear whether foundation rules easily can be applied elsewhere, whatever the resulting inconsistency across institutions.

This debate also extends to the treatment of DAFs, where the identity of the donor-advisor and decisionmaker for the use of grants is often less apparent than a foundation’s staff making decisions. Many of these donor advisors do not want to be solicited any more than they want various operating charities to broadcast their names.

Providing Different Limits for Deductibility

The tax laws layer up multiple limits on deductibility: 20, 30, 50, and 60 percent. Pity the ordinary taxpayer trying to understand IRS explanations such as how the limit based on 60 percent of adjusted gross income will apply to cash contributions to 50 percent limit organizations.

For significant gifts by the wealthy, most contributions are denied a deduction under any of the percentage limits. In this regard, we find the 30 percent limit on contributions to foundations to be of limited effect or value. But extending the rule to DAFs could well affect the more moderate-income donors engaged there. And DAF assets seem to be more flexible and less tied up than endowments and real estate investments at many other charitable institutions.

As for the 30 percent limit on deductions of capital gains property, the rule applies more consistently across charities and makes sense as a backstop limiting what is effectively an unfair double deduction for capital gains income.

In sum, consistency across charitable institutions does not create a case for extending foundation deductibility rules to other organizations, but the inverse is true in some cases.

Pulling Donor-Advised Funds and Other Charities into the Foundation Orbit

Each of the five issues discussed previously has been raised in recent debates over the treatment of DAFs. These issues can be raised for all charities, not just for foundations or DAFs.

Application of limits to specific institution forms at times creates inefficiency in giving. For instance, an endowment at a DAF or a foundation seems to be far more adaptable to current needs than endowment of real estate donated to almost any charity or than cash to public charity with purposes defined more narrowly than most foundations and almost all DAFs.

Consistency also can't easily be invoked as a sufficient reason to extend foundation rules to DAFs when that still leaves inconsistency between those organizations and endowments and assets held by other charitable organizations.

Given that so much of the attention to foundations derived from a concern about wealthy individuals and organizations, it may make sense to require consistent limits for the wealthy, as by analogy society does when applying higher rates of income taxation to them. Thus, attempts to require payouts or disclosure by the wealthy—assuming they can be made workable—might be extended beyond foundations. At the same time, rules applied to foundations or other specific institutional forms might be abandoned when they don't meet a stated objective. For instance, if the goal is some control over the activities of the wealthy, do we want to prevent modest donors from building up assets in a DAF for their children's use or for some grander project requiring multiple years of contributions?

SUMMARY

Perhaps the best that can be said about applying charitable tax rules to the specific institutional form of the foundation is an administrative statement: rules relating to endowments can be applied most easily to institutions that retain substantial endowments as their primary asset and have limited revenues from operations. At the same time, the history of taxation tells us that wealthy individuals and institutions will always be singled out for special attention. Whether the rules then-devised fulfill their intended purpose is another matter.

NOTES

- ¹ This paper was originally presented at the National Center on Philanthropy and the Law Conference on Reconsidering Private Foundations after Five Decades, New York University, October 24, 2019. The authors are especially thankful to Reina Mukai at Candid for data on the activities of foundations.
- ² Where possible, we report on net worth with all assets calculated at market values. However, often the data on net worth are not available, at least historically. The best foundation data historically has been reported on an asset basis, but for the most part, that approximates their net worth. Among other charitable organizations, however, debt is more prevalent. In general, net worth is the better measure by which to make comparisons, and, at least for the past few decades, the Federal Reserve provides estimates of their net worth on a market basis.
- Reporting on “endowment” across the sector can also be misleading. Assets within foundations approximate their endowment, as well as net worth, whereas in the rest of the charitable sector neither assets kept in reserves nor operating funds are accounted for as endowment. Buildings and land, the dominant assets for many charities, similarly are not counted as endowment, though in many ways they can be more fixed or “endowed” in their designated usage than endowment funds. Complicating measurement issues, charities usually report real estate at book value rather than market value. Meanwhile, some trusts only report book value as well.
- ³ See “Community Health Needs Assessment for Charitable Hospital Organizations – Section 501(r)(3),” Internal Revenue Service, last updated August 21, 2020.
- ⁴ Joshua Hatch and Megan O’Neil, “Many Big Nonprofits Rapidly Stockpiling Endowment Cash, Chronical Data Shows,” *Chronicle of Philanthropy*, July 26, 2017.
- ⁵ “Mr. Rockefeller’s Bad Break,” *Inter Ocean*, April 17, 1912.
- ⁶ See also Benjamin Soskis, “Philanthropy and the Quest for Civic Competence,” *HistPhil*, December 11, 2015.
- ⁷ Troyer continues: “The possibility of diversion of charitable assets to donors – substantial where the donor was the only party watching – was far more remote where persons whose focus was the charity’s mission constituted its governing body, were its funders, or, at a minimum, were reviewers or observers capable of taking practical steps aimed at preventing or rectifying the diversion” (Troyer 2000, 63).
- ⁸ These data from the mid-1990s likely reflect most donors today, but they do not necessarily capture whether there is a small but perhaps growing class of very wealthy donors starting to donate during life rather than death.
- ⁹ This relatively constant estimate is calculated by dividing total giving (provided by Giving USA in various issues of the *Annual Report on Philanthropy*) by GDP. See for example “Giving Statistics,” Charity Navigator, accessed December 11, 2020.
- ¹⁰ See Eugene Steuerle, “The Zuckerberg Charitable Pledge and Giving from One’s Wealth,” *The Government We Deserve* (blog), January 11, 2016.
- ¹¹ For those below the limit, the choice remains more neutral: they can achieve the same tax advantage whether they park assets within a charity or donate each year to the charity their returns from assets they might have given away.
- ¹² See Sally Ehrenfried, “Two Tax Policies Affecting Foundations and Nonprofits in 2020,” *sgEngage*, January 28, 2020.

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