



July 17, 2017

The Honorable Orrin Hatch
Chairman
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Hatch and Ranking Member Wyden:

Thank you for your leadership in taking on the great challenges presented by comprehensive tax reform, and for soliciting the input of stakeholders in your efforts. To help these efforts, the Council on Foundations (“Council”) wishes to share its suggestions relating to specific tax policy provisions that have a significant impact upon the philanthropic sector. The Council believes that it is critical that tax reform improves and does no harm to these provisions so that the philanthropic sector can do its part to help meet the needs of the communities we serve.

As a threshold matter, we ask you to only pursue changes in tax policy that encourage – not stifle – the philanthropic tools that foundations rely on to invest in causes, programs, research, and activities that are essential for thriving communities, including by undertaking actions to support the current-law deduction for charitable giving.

General Background

The Council has a membership of nearly 1,000 grantmaking foundations and corporate giving programs which collectively grant and invest billions each year to help meet the many needs of the communities they serve. As the voice of philanthropy nationally, the Council works to create an environment in which philanthropy can grow and thrive, and seeks to promote policies that enable the philanthropic sector to work most effectively.

We affirm the continued commitment of the Council and the philanthropic community to do our part to help address the grave fiscal challenges confronting our nation. In particular, the Council recognizes the great need for the philanthropic sector to step up to meet the needs of some of our most vulnerable communities and neighbors. At the same time, the Council urges you and your colleagues to consider that significant community needs and diminishing public dollars create increasing demands and strain on

our charitable organizations. These organizations look to philanthropy – both organized structures such as foundations and individual American donors – to support their efforts. As you consider tax reform measures, we implore you to recognize that the charitable sector cannot fully step in to do more if changes to tax policy result in fewer dollars to charities.

The Council sees clearly that its members are committed to meet the challenge of increased needs. In 2016, the last year for which complete data is available, foundations contributed through grants and other means \$59.28 billion to help meet the needs of the communities they serve.

Our members are committed to help not only by offering their own resources, but by identifying ways in which to do more with less. Philanthropy has a proven record of using resources in highly innovative ways to achieve solutions to intractable problems, and the Council's members have realized dramatic results by leveraging their own resources to implement those innovations on a large scale. Philanthropy creates thriving communities by finding new ways to create jobs, spur community growth, support the vulnerable, and empower your constituents to improve their lives.

Philanthropy has a unique ability and freedom to take risks and innovate in ways government and for-profit entities cannot. Philanthropic organizations provided the charitable dollars and innovative thinking behind the efforts to conquer polio in the United States, eliminate smallpox worldwide, paint stripes on traffic lanes to prevent accidents, facilitate the creation of national parks and nature preserves, develop private colleges and universities, and so much more.

Maintain the Full Value of the Charitable Deduction

The Council's top legislative priority is to preserve the full value of the charitable deduction. Any limiting change in the current law relating to the charitable deduction provided by Internal Revenue Code section 170 would compromise philanthropy's capacity to serve, as also would any change in the broader Internal Revenue Code that reduces the accessibility of the charitable deduction. Making such changes would result in denying crucial help to the communities and individuals who rely upon philanthropy to help meet their needs and realize their aspirations at a time when they have few other places to turn.

The deduction for charitable contributions is a long-standing recognition of the value our society places on the selfless act of charitable giving. This deduction is unique among tax incentives in that it promotes behavior that does not primarily benefit the person undertaking the action—rather, the rewarded action benefits unrelated persons, communities, and society as a whole. Unlike, for example, state and local taxes, charitable contributions are not required and are a selfless, voluntary act of giving by a donor. Unlike mortgage interest, which results from a contractual obligation, charitable contributions do not relate to an expenditure which benefits the person claiming the deduction. Every other deduction either mitigates the cost of an expenditure that must be made in any event, or subsidizes the cost of an expenditure relating to the consumption or investment of the taxpayer. Conversely, a charitable donor never benefits financially from making a contribution.

Americans are unquestionably generous by nature, contributing more money to charity each year than the GDP of some wealthy nations (*e.g.*, Denmark, Israel). Research indicates, however, that the deduction for charitable contributions does in fact promote giving—particularly with respect to the amount donated.

For example, data derived by the Tax Policy Center at the Urban Institute and Brookings Institution show that under current law a \$1 contribution to charity on average costs the giver \$0.77. According to the research, the combined impact of changes to the value of the charitable deduction proposed by former Chairman Camp in his Tax Reform Act of 2014 would increase the average cost of a \$1 contribution to \$0.88—an increase of more than 14 percent. All else being equal, increasing the cost of a charitable contribution will reduce the amount contributed.

Other data supports this conclusion. In a study regarding the impact of changes to the Internal Revenue Code on charitable giving, the American Enterprise Institute estimated that imposing a cap on the value of charitable contributions would lead to an across-the-board decrease in the amount donated each year of 4.35 percent, which, based upon 2016 data of the yearly overall amount of charitable giving in the United States, would amount to a decline in giving of nearly \$17 billion.

Further research on this topic by Indiana University studies the potential impact of the proposals in the House Republican Tax Blueprint to decrease the highest individual marginal tax rate and increase the standard deduction (which the Council does not oppose in their own rights). Drawing upon data on the charitable giving behavior of American families from the multi-decade Panel Study of Income Dynamics, the largest and longest running household behavioral survey in the world, Indiana University estimates that combining these two proposals would in isolation lead to a reduction in charitable giving of between \$4.8 and \$13 billion per year, depending on the elasticity of taxpayers to tax-law changes. There are ways to prevent such a reduction, which will be discussed below.

By any estimate, lowering the value of the charitable deduction would reduce charitable contributions by many billions of dollars in the coming years. Donors do not choose to give to charity because of the tax deduction. However, the deduction very much affects the amount that they are able to give. Basic economics, not to mention simple common sense, indicate that if charitable giving is made more expensive, less charitable giving will take place.

For these reasons, the Council continues to be very concerned about proposals to impede charitable giving by further limiting the charitable deduction, limiting the value of the deduction for certain gifts, or enacting proposals that would erode the continued incentive provided by the charitable deduction.

The many hundreds of billions of dollars which foundations have invested in their communities—funds used to provide for a wide range of a community's needs, ranging from homeless shelters to medical research to education—have been critical to allowing communities to thrive. These funds cannot be replaced by other sources if philanthropy is forced to curtail giving as a consequence of diminished resources.

As noted previously, tax policy experts from both sides of the aisle have observed how the charitable deduction is unique among tax deductions in that it encourages behavior that is both discretionary and is solely for the benefit of others. Because the charitable deduction is unique, even sponsors of legislation to codify the “Buffett Rule”, including S. 321 and H.R. 766 from the 114th Congress, have taken care to single out charitable contributions from other tax deductions, and to preserve their treatment under current law.

Similarly, Martin Feldstein, who served as chairman of the Council of Economic Advisers under President Ronald Reagan, wrote in a February 22, 2013 op-ed in *The Wall Street Journal*, “The existing charitable deduction in particular deserves to be maintained. Unlike other deductions and exclusions, it does not

benefit the taxpayer but provides important private support for universities, religious and cultural institutions, and hospitals.” Though the Council takes no position on either the Buffett Rule or positions advocated by Professor Feldstein, the Council agrees that, whatever course the Senate Finance Committee and this Congress choose to take, the current law incentive provided by the charitable deduction should be preserved.

Whether by denying donors the full value of their charitable contribution tax deduction by imposing a dollar cap on the amounts which may be deducted, capping at a marginal rate the value of the deduction, imposing a floor on the ability to deduct charitable contributions, or any other ancillary tax change, reducing the value of the charitable tax deduction would lead to a significant reduction in contributions.

Although the Council opposes any change in current law relating to the charitable deduction, it strongly supports any efforts that would make current law work better. In particular, the Council is committed to combating any abusive practices that permit bad actors to potentially game the system. The Council stands ready to assist the Congress, and in particular the Senate Finance Committee, in identifying and addressing any concerns the Committee might have regarding the current-law charitable deduction, and ensuring that enforcement measures effectively target any abusive behavior that could both tarnish the sector and harm those whom we serve.

Above-the-line Deduction for Charitable Giving

As highlighted above, data shows that enacting tax reform that decreases marginal tax rates and increases the standard deduction has the unfortunate externality of reducing charitable giving by billions of dollars per year. Fortunately, the Indiana University data also shows that enacting a so-called “universal” charitable deduction—i.e., an above-the-line deduction for charitable giving—would result in a multi-billion dollar increase in charitable giving per year, even when paired with the other changes discussed above.

According to Indiana University’s study, introducing an above-the-line deduction for charitable giving would result in a yearly increase in charitable giving of between \$3.7 and \$12 billion. Similarly, introducing such a deduction in conjunction with increasing the standard deduction and lowering the top marginal income tax rate would increase charitable giving between \$1 and \$4.8 billion per year—which represents a net positive shift in the amount of charitable giving of between \$5.8 and \$17.9 billion per year.

Each of the estimates derived by Indiana University assume the continuance of all current-law restrictions on the charitable deduction (e.g., the Pease limitation), which impact only those taxpayers who itemize their deductions under current law, typically taxpayers of more than modest means. Thus, it appears that the primary persons who would be impacted by the introduction of an above-the-line deduction for charitable contributions would be those generous persons who do not currently avail themselves of the charitable deduction because they do not itemize.

Additionally, one would observe that enacting an above-the-line deduction for charitable giving would have a salutary effect on charitable giving, whether under current law or as part of the tax reform that has been discussed thus far in the 115th Congress. The Council supports the adoption of such a provision, and looks forward to working with the Senate Finance Committee in the coming months to help further develop it.

CHARITY Act

In June 2017, Senate Finance Committee Members John Thune and Bob Casey re-introduced the Charities Helping Americans Regularly Throughout the Year (CHARITY) Act (S. 1343). The CHARITY Act would resolve a number of tax policy issues in a way that is sensible and supportive of charitable giving, including: (1) making donor-advised funds (“DAFs”) an eligible charity for purposes of the current tax provision that allows an IRA owner to exclude from his or her income up to \$100,000 per year in IRA distributions that are made directly from the IRA to certain public charities (the “IRA charitable rollover provision”); (2) simplifying and streamlining the current-law excise tax on foundation investment income; (3) promoting transparency by requiring nonprofits to file their annual returns electronically; (4) encouraging philanthropic enterprises to donate profits to charity by making a limited exception to the excess business holding rules; (5) safeguarding donor information and improving tax administration by eliminating alternative rules for substantiating charitable contributions; and (6) authorizing the Treasury Department to adopt regulations that align the simplified standard mileage tax deduction rate applicable to charitable use of vehicles with the mileage rate for medical and moving purposes.

The Council supports the CHARITY Act and its focus on “removing unnecessary barriers” for and supporting the “philanthropic mission” of charitable organizations—including foundations. The CHARITY Act would resolve several issues facing the philanthropic sector that the Council has previously brought to the attention of the Senate Finance Committee, discussed further below.

DAFs are a unique and invaluable charitable giving vehicle that allow donors to establish charitable accounts at vetted public charities, such as community foundations, and remain involved in supporting the charitable causes and issues they care about. Community foundations control the oversight and management of funds on behalf of families or individuals, and in many cases, have the discretion to direct some of the resources to priority causes the foundation identifies.

DAFs are used exclusively for charitable purposes. DAFs engage donors and nurture greater charitable activity in a community. For example, in a recent Urban Institute survey of funds managed by community foundations, 88 percent of surveyed foundations receiving DAF funds reported that their donors participated directly in foundation-sponsored events. In addition, more than 70 percent of foundations reported that the average age of a DAF donor is between 46 and 64 years old. Furthermore, 81 percent of foundations report that their donors remain involved in the foundation or their communities after donating. These survey results highlight the unique ability of DAFs to attract and engage donors and provide an important entry point for long-term community involvement.

The Council also strongly believes in the value of endowed philanthropy. The compulsion to pay out all charitable dollars today in order to address immediate needs is woefully shortsighted. Philanthropy does not think just of the latest development, the next election, or the next business cycle. Rather, foundations must constantly be thinking of the needs of the next generation.

When our country was in the middle of a prolonged recession and community needs were highest, many donors saw a drop in their incomes and foundations saw a decline in their invested assets. However, DAF donors were able to make gifts to local housing programs, workforce development efforts, and family service organizations because they had intentionally made their charitable donation during more prosperous times. Because of their intentional gifts made years earlier with just such an economic downturn in mind, DAF donors were able to continue to give at sustained levels throughout the

recession and direct their funds to needs in their communities as they arose.

Encouraging further charitable contributions to DAFs by allowing them to be eligible for the current-law IRA charitable rollover provision would be a great benefit to endowed philanthropy, community foundations, and the diverse and myriad communities that each serve.

Internal Revenue Code section 4940 requires private foundations to pay an annual excise tax equal to two percent of their net investment income; that tax is reduced to one percent in any year in which a foundation's distributions (measured as a percentage of assets) exceed the foundation's average payout rate over the preceding five years. The current two-tier system actually serves as a regressive disincentive to increased giving, especially in times of crisis or economic turmoil. The more a foundation gives in one year, the harder it will be to avoid the higher excise tax rate while still maintaining mission-enhancing and fiscally sustainable payouts in the years to come. Many within and outside of government have noted this unintended result.

For example, a study by Professors Richard Sansing of Dartmouth and Robert Yetman of the University of California found that current law can have "countervailing effects on foundation behavior." The study noted that current law "creates a tax-induced incentive" to reduce contributions in "difficult economic times" such as we are now experiencing "because a high distribution this year makes it more difficult to qualify for the lower rate during the next 5 years." In such instances, foundations subject themselves to higher tax rates in future years unless they also reduce their giving at the very times when such support is most needed. This is particularly true for smaller foundations, for whom extraordinary giving in one year has a disproportionately higher impact on the calculation.

Yet, private foundations are particularly adept at responding quickly in times of emergency, and tax policy should facilitate – rather than hinder – this generosity. For example, the John D. and Catherine T. MacArthur Foundation awarded over \$7 million in the aftermath of Hurricanes Katrina and Rita for urgent needs such as mobilizing volunteers, developing affordable housing for victims, and establishing regional recovery loans. Dozens of private foundations responded swiftly to the devastating tornado that struck Moore, Oklahoma in 2013, providing victims with access to food, water, shelter, and other basic needs. In 2014, the Conrad A. Hilton Foundation awarded over \$1 million to nonprofits that work with refugees fleeing the humanitarian crisis in Syria. These are just three out of countless examples of private foundations acting swiftly to help communities get back on their feet after tragedy strikes. We urge Congress to remove this disincentive to pay out during these times to avoid a higher tax rate in the future. The tax code should encourage a charitable response to imminent needs instead of hindering it.

Additional externalities of a two-tier excise tax include that it drains a foundation's mission-focused operating resources, increases operating uncertainty, mires foundation staff in unnecessary complexity, and consumes significant foundation resources spent managing exposure to the excise tax. Thus, the excise tax has a double-barreled negative impact (once as the actual tax, and once more in the form of operating costs) on the resources a foundation can offer the community it serves. Moreover, the complexity and uncertainty the two-tiered structure engenders diminishes valuable charitable resources, both funds and time.

The private foundation excise tax was enacted in 1969 to help fund what was then the new IRS office of Exempt Organizations. Yet the tax is not serving its stated purpose because the funds are not—and never have been—specifically dedicated to that office. Moreover, the amounts collected under the tax far exceed the IRS's costs in dealing with private foundations. As Eugene Steuerle of the Urban Institute

stated in recent Congressional testimony, Congress should “[r]educe and dramatically simplify the excise tax on foundations. Whatever Congress gives back here will automatically be paid out to the public in the form of greater charitable activity...The current design discourages payouts today because they can increase future excise taxes (which are higher when giving tomorrow does not exceed giving today).”

There is broad support for simplifying and reducing the excise tax. For many years, tax experts and even the Joint Committee on Taxation have recommended simplifying the tax to a single, flat rate. Former-President Obama proposed simplifying the tax in several of his Administration’s Budgets. In the 114th Congress, H.R. 644, the American Gives More Act of 2015, simplifies the private foundation excise tax to a single tier and reduces the rate to 1 percent, passed the House of Representatives by a wide margin. And as noted, the CHARITY Act (S. 1343) would likewise streamline and simplify the private foundation excise tax. The Council strongly supports the passage of S. 1343, and encourages members of the Senate to bring the bill to the floor for a vote or include its provisions as part of any comprehensive tax reform bill.

Closing

In closing, the Council applauds your efforts to make positive changes to the tax code, and respectfully asks that you (1) maintain the full value of the charitable deduction, (2) support an above-the-line deduction for charitable giving, and (3) support the passage of the CHARITY Act (or include its provisions as part of your efforts to reform the tax code).

In addition, we present ourselves as one resource to consult with respect to making tax law changes that could impact charitable giving or the ability of charities to accomplish their positive missions, and respectfully suggest that the Senate Finance Committee seek the input of stakeholders in the charitable sector before making any such changes. The impact of these changes will primarily be borne not by those individuals with the most resources, but by those with the least—the struggling members of our communities who rely on philanthropy to help themselves and their families meet the challenges of daily life.

Thank you again for your leadership in reforming our tax code. The Council on Foundations stands ready to work with you on this crucial task.

Very truly yours,



Vikki Spruill

President and Chief Executive Officer