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REPORT
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LIMITATION ON DEDUCTION IN CASE OF CONTRIBUTIONS BY INDIVIDUALS FOR BENEFIT OF CHURCHES, EDUCATIONAL ORGANIZATIONS, AND HOSPITALS

JULY 20, 1961.—Ordered to be printed

Mr. BYRD of Virginia, from the Committee on Finance, submitted the following

REPORT

together with

MINORITY AND SUPPLEMENTAL VIEWS

[To accompany H.R. 2244]

The Committee on Finance, to whom was referred the bill (H.R. 2244) relating to the deduction for income tax purposes of contributions to charitable organizations whose sole purpose is making distributions to other charitable organizations, contributions to which by individuals are deductible within the 30-percent limitation of adjusted gross income, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The committee amendments are as follows:

Strike out all after the enacting clause and insert the following:

That (a) section 170(b)(1)(A) of the Internal Revenue Code of 1954 (relating to limitation on amount of deduction for charitable contributions by individuals) is amended by striking out "or" at the end of clause (ii) and by inserting after clause (iii) the following new clauses:

"(iv) an organization referred to in section 503(b)(3) organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a college or university which is an organization referred to in clause (ii) of this subparagraph and which is an agency or instrumentality of a State or political subdivision thereof, or which is owned or operated by a State or political subdivision thereof or by an agency or instrumentality of one or more States or political subdivisions, or

"(v) a corporation, trust, fund, or foundation exempt from tax under section 501 which is organized and operated exclusively for the purpose of distributing its net earnings for each taxable year on or before the 15th day of the third month following the close of such taxable year to one or more of the organizations referred to in clauses (i), (ii), and (iii) of this subparagraph

and which, if it may distribute any portion of the principal, may make such distribution only to one or more of the organizations referred to in such clauses,".

(b) Section 170(b)(1)(B) of such Code is amended by striking out "any charitable contributions to the organizations described in clauses (i), (ii), and (iii)" and inserting in lieu thereof "any charitable contributions described in subparagraph (A)".

SEC. 2. Clause (iv) of section 170(b)(1)(A) of the Internal Revenue Code of 1954, as added by subsection (a) of the first section of this Act, shall apply to taxable years beginning after December 31, 1960. Clause (v) of section 170(b)(1)(A) of such Code, as added by subsection (a) of the first section of this Act, shall apply to taxable years beginning after December 31, 1961.

Amend the title so as to read:

An Act to amend the Internal Revenue Code of 1954 to increase the limitation on the amount of allowable charitable contributions which may be made by individuals to certain organizations for the benefit of churches, educational organizations, and hospitals.

SUMMARY OF COMMITTEE AMENDMENT

The House-passed bill, the substance of which has been retained without change by your committee's amendment, provides that charitable contributions to a foundation, etc., organized and operated exclusively for the purpose of paying over each year its entire net earnings (and any portion of its principal it may distribute) to a church, school, hospital, or medical research organization will qualify for the extra 10-percent deduction. This provision of the House bill, as approved by your committee, is to apply to taxable years beginning after December 31, 1961.

Your committee's amendment also makes this extra 10-percent deduction available in the case of contributions to an organization which normally receives a substantial part of its support from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public, organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a State university or college, including a land-grant college or university. This provision, which is added by your committee, is to apply to taxable years beginning after December 31, 1960.

GENERAL EXPLANATION OF HOUSE PROVISION

As described in the summary of the committee amendment, the entire substance of the House-passed bill has been approved and retained by your committee without change.

Under present law deductions for charitable and related contributions or gifts in the case of individuals generally may not exceed 20 percent of their adjusted gross income. However, an additional 10 percent of adjusted gross income, or 30 percent in all, may be deducted if at least the 10 percent is accounted for by contributions to churches or conventions or associations of churches, operating educational organizations or hospitals or certain related medical research organizations. The operating educational organization must be an educational organization which normally maintains a regular faculty and curriculum and has a regularly enrolled body of students in attendance where its educational activities are carried on.

The additional 10 percent was provided for in the Internal Revenue Code of 1954 and, as the committee reports ind cate, was designed to aid the churches, operating schools, and hospitals "in obtaining the additional funds they need, in view of their rising costs and the relatively low rate of return they are receiving on endowment funds." In other words, Congress in 1954 recognized the special needs of these institutions and provided additional incentives for contributions to them. However, the attention of your committee has been called to cases where prospective contributors in the case of these same institutions find it difficult, or are unwilling, to turn over stock in family-held corporations or other property to the organizations in these three categories for their unrestricted use. Yet they are willing to have such stock or other property set aside in separate corporations, trusts, or foundations for these institutions with all of the income from this stock or other property being distributed currently to these churches, schools, or hospitals (or related medical research organizations). They are also willing to provide that if any portion of the principal so set aside in one of these corporations, trusts, or foundations is to be distributed, it may be distributed only to one of the specified classes of the organizations. Your committee, like the Committee on Ways and Means of the House, believes that by allowing the extra 10-percent deduction in the case of charitable contributions of this type, more funds will be made available to churches, schools, and hospitals, etc., and, therefore, that this bill will aid in carrying out the original intent of this special additional 10 percent deduction as outlined in the 1954 committee reports.

In view of these considerations, your committee has approved the House-passed provision without change. As passed by the House and as approved by your committee, the bill amends the Internal Revenue Code (sec. 170(b)(1)(A)) to provide that the extra 10-percent deduction (or 30 percent in all) is to be available not only in the case of charitable contributions, etc., made directly to one of the churches, operating educational organizations or hospitals, etc., but also in the case of corporations, trusts, funds, or foundations exempt from tax (under sec. 501), which are organized and operated exclusively for the purpose of distributing their net earnings to one or more of these churches, operating schools or hospitals, etc. These net earnings must be paid over to one or more of these types of institutions on or before the 15th day of the third month after the end of the the organization's taxable year. Moreover, the bill makes it clear that if one of these corporations, trusts, funds, or foundations may distribute any portion of the principal contributed to it, it may make this distribution only to one or more of the specified types of organizations.

This provision (clause (v) of sec. 170(b)(1)(A) of the code) is to apply to taxable years beginning after December 31, 1961.

GENERAL EXPLANATION OF COMMITTEE AMENDMENT

Your committee's amendment also adds a new category (clause (iv)) to section 170(b)(1)(A) of the Internal Revenue Code, relating to organizations which qualify for the extra 10-percent deduction for charitable contributions. The new category added by your committee's amendment comprises organizations which normally review

a substantial part of their support from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a State university or college, including a land-grant college or university. The purpose of this provision is to extend the extra 10-percent limitation on deductions for charitable contributions to a university endowment association, the activities of which include encouraging and soliciting private support for the university, receiving and holding in trust all property given to the association for the benefit of the university or college, the administration of the endowment funds, and the maintenance of separate funds for gifts and bequests received for uses for which State-appropriated funds are not available or are insufficient, such as scholarships, student loans, equipment, furnishings, supplies, lectureships, and libraries. In some instances, university endowment institutions of the type included by your committee's amendment hold title to property comprising part of the campus area of a college or university, and participate in the erection of university buildings. In general, these foundations do a variety of things which are mormally accepted functions of colleges and universities. They merely do them through separate corporations rather than through the university corporation.

Because the functions of these university endowment foundations are so similar to functions normally performed directly by colleges and universities, your committee does not believe that the extra 10-percent deduction should be denied in the case of contributions made to such foundations.

Moreover, the attention of your committee has been called to the fact that in at least 9 States [1] legal restrictions limit the ability of State and land-grant colleges or universities to receive directly gifts and bequests from the public for particular purposes. This is especially true of gifts not made in trust. Because of these restrictions, endowment foundations have been created in connection with many State colleges and universities (often by alumni groups) for the purpose of receiving gifts and bequests from the general public and of making expenditures for the benefit of such colleges and universities. Private universities or colleges, on the other hand, are not similarly restricted in their ability to receive gifts and bequests directly. Accordingly, your committee has limited the scope of its amendment to endowment foundations which normally receive substantial support from the Federal or State Government or political subdivisions thereof or from direct or indirect contributions from the general public established to make expenditures to or for the benefit of State colleges and universities, including land-grant colleges and universities. Moreover, this limitation will prevent private foundations from qualifying for the extra 10-percent deduction under this provision.

This provision (clause (iv) of sec. 170(b)(1)(A) of the code) is to apply to taxable years beginning after December 31, 1960.

[1] Iowa, Kansas, New York, Oregon, South Dakota, Utah, Virginia, West Virginia, and Wisconsin.

CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SECTION 170 OF THE INTERNAL REVENUE CODE OF 1954

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS

(a) ALLOWANCE OF DEDUCTION.—

(1) GENERAL RULE.—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary or his delegate.

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(b) LIMITATIONS.—

(1) INDIVIDUALS.—In the case of an individual the deduction provided in subsection (a) shall be limited as provided in subparagraphs (A), (B), (C), and (D).

(A) SPECIAL RULE.—Any charitable contribution to—

(i) a church or a convention or association of churches,

(ii) an educational organization referred to in section 503(b)(2), [or]

(iii) a hospital referred to in section 503(b)(5) or to a medical research organization (referred to in section 503(b)(5)) directly engaged in the continuous active conduct of medical research in conjunction with a hospital, if during the calendar year in which the contribution is made such organization is committed to spend such contributions for such research before January 1 of the fifth calendar year which begins after the date such contributions is made,

(iv) an organization referred to in section 503(b)(3) organized and operated exclusively to receive, hold, invest, and administer property and to make expenditures to or for the benefit of a college or university which is an organization referred to in clause (ii) of this subparagraph and which is an agency or instrumentality of a State or political subdivision thereof, or which is owned or operated by a State or political subdivision thereof or by an agency or instrumentality of one or more States or political subdivisions, or

(v) a corporation, trust, fund, or foundation exempt from tax under section 501 which is organized and operated exclusively for the purpose of distributing its net earnings for each taxable year on or before the 15th day of the third month following the close of such taxable year to one or more of the organizations referred to in clauses (i), (ii), and (iii) of this subparagraph and which, if it may distribute any portion of the principal, may make such distribution only to one or more of the organizations referred to in such clauses,

shall be allowed to the extent that the aggregate of such contributions does not exceed 10 percent of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback to the taxable year under section 172.

(B) GENERAL LIMITATION.—The total deductions under subsection (a) for any taxable year shall not exceed 20 percent of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback to the taxable year under section 172. For purposes of this subparagraph, the deduction under subsection (a) shall be computed without regard to any deduction allowed under subparagraph (A) but shall take into account any charitable contributions [to the organizations] described in [clauses (i), (ii), and (iii)] *subparagraph (A)* which are in excess of the amount allowable as a deduction under subparagraph (A).

MINORITY VIEWS

This bill is designed specifically to encourage a proliferation of foundations which would be established by individuals and families. Fully tax deductible capital contributions could be made annually to such foundations to the extent of 30 percent of each individual's taxable annual income. The subject bill would broaden existing law by allowing the full 30 percent deduction for contributions to churches, schools, and hospitals without requiring the last 10 percent increment to be contributed directly as the law now requires.

The tax base is being dangerously eroded by many forces, among them tax-exempt trusts and foundations. Not only is the tax base being eroded, but even more harmful social and political consequences may result from concentrating, and holding in a few hands and in perpetuity, control over large fortunes and business enterprises. The attendant inequities resulting from the tax treatment of contributions, particularly in the form of capital, to foundations are being magnified daily.

Laudable as may be the motives of those who contribute to, and worth while as are the services performed by, churches, schools, and hospitals, the channeling of private funds into such purposes must be done in such a way as to avoid interference with other goals of our society.

There are now in existence some 13,000 foundations, with assets of about $12 billion. Of more concern than numbers and amounts in existence is the trend. Approximately 1,200 new foundations are being created every year, and 87 percent of those now in existence have been established since 1940. At present rates of establishment of foundations, substantial control of our economy may soon rest in the "dead hands" of such organizations.

It was just such a situation which necessitated the Statute of Mortmain in 1279. It was just such a situation, and the realization that economic mobility was necessary for the growth and preservation of political democracy, which led the last of our States to outlaw entail and primogeniture within a few years after the War of the Revolution.

The social, political, and economic implications of the growth of foundations should be thoroughly studied. This bill encourages a movement which needs no encouragement. This bill is designed specifically to encourage the establishment of new foundations of the type where control will remain in the hands of the ostensible donor to charity.

Under certain circumstances, it may be to a taxpayer's financial advantage to make "charitable contributions," considering the vagaries of our tax law. This would be true, for instance, in the case of a taxpayer in a high tax liability bracket who divests himself of certain capital assets.

Consider, for instance, the person who has a taxable income of $150,000. His tax (single) would be $111,820, leaving him a net cash amount of $38,180. If he transfers $50,000 worth of stock to

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a foundation—and bear in mind he can still control the assets or business represented by this amount of stock—he will automatically reduce his tax to $67,320, thereby retaining $82,680 of his income for that year. In other words, by transferring stock to a foundation, where he can still exercise control, the taxpayer reduces his tax liability by almost as much cash as the stock is worth. Assuming a sizable capital gain, he actually will be better off financially if he "gives" the stock to a foundation than if he sells the stock, pays the capital gains tax, and keeps the balance.

Present law is amply generous in making provision for deductions for contributions to charitable and eleemosynary activities. There is a definite danger in providing tax inducements which tend to concentrate wealth in the hands of a few, especially where the control of such wealth is removed from ostensible ownership and from the free choices presented by the marketplace and by the democratic processes of a free government, a free economy, and a free society. The recognition of this danger, inherent in this bill, in no wise imputes a lack of appreciation for the worthwhile purposes served by eleemosynary institutions.

Already abuses other than those related to tax equity are apparent. The use of foundations in recent corporate control battles points up the problem. Allan P. Kirby used the tax-exempt Fred M. Kirby Foundation to purchase Alleghany stock. The J. M. Kaplan Fund, Inc., and the Albert A. List Foundation were used in a somewhat similar fashion in the effort of Glen Alden Corp., to gain control of Endicott Johnson.

A tax-exempt foundation can be started with relatively small contributions and grow very rapidly, affording an individual or group the opportunity of controlling large amounts of wealth. The benefits which accrue to those controlling such wealth, and the deleterious effects on society, may be equally large, even though most of the earnings of the foundation go to an eleemosynary operation of unquestioned value to society. This bill should be defeated.

RUSSELL LONG.
ALBERT GORE.
EUGENE MCCARTHY.

SUPPLEMENTAL VIEWS

I agree with Senator Gore in opposition to the enactment of H.R. 2244 without endorsing all the text of his minority views.

CLINTON P. ANDERSON.

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